S. Hrg. 98-338

IRREGULARITIES IN NAVY SHIP PROCUREMENT

HEARINGS

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

MAY 3 AND 4, 1983

Printed for the use of the Committee on Governmental Affairs

U.S. GOVERNMENT PRINTING OFFICE
23-821 O WASHINGTON : 1983

S401-65

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IRREGULARITIES IN NAVY SHIP PROCUREMENT

TUESDAY, MAY 3, 1983

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The subcommittee met at 10 a.m., in room 342, Dirksen Senate Office Building, under authority of Senate Resolution 76, section 13, dated March 2, 1983, Hon. William V. Roth, Jr. (chairman of the subcommittee), presiding.

Members of the subcommittee present: Senator William V. Roth, Jr., Republican, Delaware; Senator Charles Percy, Republican, Illinois; Senator Thad Cochran, Republican, Mississippi; Senator Sam Nunn, Democrat, Georgia; and Senator Jeff Bingaman, Democrat, New Mexico.

Also present: Senator John Stennis, Democrat, Mississippi.

Members of the professional staff present: S. Cass Weiland, chief counsel; Eleanore J. Hill, chief counsel to the minority; Katherine Bidden, chief clerk; James B. McMahon and Rodney G. Smith, deputy chief counsels; Chuck Morley, chief investigator; David Glendinning and Tom Karol, staff counsels; Karen Hainer, investigator; John Sopko and Terry Bostic, assistant counsels to the minority; Glenn Fry, minority staff investigator; Sarah Presgrave, executive assistant to the chief counsel of the majority; Mazie Haley and Mitch Goldberg, subcommittee staff.

[Senators present at convening of hearing: Senators Roth, Cochran and Bingaman.]

OPENING STATEMENT OF SENATOR ROTH

Chairman ROTH. The subcommittee will please be in order. This morning the Senate Permanent Subcommittee on Investigations begins a 2-day hearing into possible fraud, waste, and abuse in the procurement of Navy ships. In fiscal year 1984, the Navy will spend a projected $12.6 billion to construct new ships. More than one-fourth of this amount is budgeted for the construction of the Navy's newest and most technologically advanced ship, the Aegis guided missile cruiser.

This hearing should provide a new perspective on the continued defense debate, a real hard look at how the Navy contracts and supervises shipbuilding at private facilities throughout the country. We in Congress need to know, and what American taxpayers demand to know, is this:

Are we truly purchasing a dollar's worth of defense for every defense dollar we spend? Frankly, this hearing and some I have recently held before the full Committee on Governmental Affairs raises more questions in my mind than answers.

The focus of this hearing will be to examine a number of allegations concerning the failure in Navy oversight of contract irregularities at one facility, Ingalls Shipyard, Pascagoula, Miss. Ingalls is the first shipyard to build and launch an Aegis cruiser. It should be noted from the outset that the subcommittee's review could have focused on other shipbuilding facilities. Indeed, the general patterns of naval oversight which have emerged appears to be weaknesses inherent in the system used to buy and build naval vessels. What we will be discussing over the next 2 days touches the very heart of our defense procruement process. The Permanent Subcommittee on Investigations has sworn admissions of labor mischarging in one small section of a major shipbuilder which the supervisor who was involved estimates the cost to be as much as $1 million and there are other examples at the same shipyard.

One reason that mischarging of labor is significant is because it does call into question all of the cost data upon which the contractor bills the Government as well as all the cost data used by the Navy to estimate future competitive shipbuilding bids.

These hearings will also identify how the Navy, acting in concert with its shipbuilders, repeatedly failed to halt any practice, whether it be waste or cost problems, that interfered with getting the ship out as quickly as possible. Additional emphasis will be given to how Government auditors and the Justice Department, the taxpayers' ultimate guardians, can and should be detecting fraud and abuse in the performance of billion-dollar defense contracts.

It should be noted here Rockwell International and other major defense contractors in the space shuttle program recently agreed to repay NASA $500,000 of alleged mischarges to Government contracts for work actually performed on other contracts.

The hearings today will begin with a summary of the investigative work performed by the subcommittee staff in identifying the practices which led to questionable cost data submitted to the Navy. Next we will hear from the Better Government Association of Chicago which initially presented these allegations to the subcommittee and which has conducted its own investigative work.

We will also receive testimony from two whistleblowers, former shipyard employees who witnessed fraudulent practices in the building of ships and when they talked about it, found themselves soon without jobs.

Later, testimony will be received from Ingalls Shipyard concerning its performance on Navy contracts. Tomorrow, Navy officials will testify about their management of defense contracts. We will receive additional testimony from the Defense Contract Audit Agency and the Department of Justice about their efforts and will acquire from these witnesses the appropriate insight on the means, legislative and otherwise, which can be developed to effectively deal with abuse of procurement of Navy ships.

At this time, I would be very happy to call upon Senator Cochran.

OPENING STATEMENT OF SENATOR COCHRAN

Senator **Cochran**. Thank you very much, Mr. Chairman. First of all, I want to express my sympathy with the goals and the stated reasons why we are here today and the purpose of this hearing. I think that it is certainly important for all of us on this subcommittee to be very aware of the possibility of abuses occurring in Defense Department procurement contract activities, and it certainly is today on the minds of all of us in the Senate as we begin to discuss the budget resolution which has been reported by the Budget Committee where we are going to be called upon to try to decide upon the appropriate level of funding of our defense activities for the next fiscal year.

So it is very much on the minds of all of us that we help assure that the Government and the taxpayers of this country get their money's worth when they contract with private sector firms who are building weapons systems, ships, armaments of all kinds for our Defense Department needs and for the security of our country.

I must say that I was somewhat disturbed, Mr. Chairman, that the initial hearing focuses on alleged abuses at only one shipyard. There are a wide range of contractors throughout the country who do business with the U.S. Navy. Ingalls Shipyard is reputed to be one of the best, turning out workmen-like products, according to the Navy and those familiar with the work at Ingalls located, incidentally, in my State of Mississippi. We are very proud to have Ingalls as a citizen of our State. I can say to the subcommittee, Mr. Chairman, that the vast majority of the workers at Ingalls in Pascagoula, Miss., are good citizens and are dedicated to giving the Government and any private contractor good work, competent work with high skill and dedication. That is the reputation of that yard and its employees.

I hope that we will guard against permitting any erroneous conclusions being drawn from whatever the facts turn out to be, and I hope this subcommittee will see that as one of its duties as well. It has disturbed me, too, that some members of the subcommittee and others have in advance of the hearing already drawn conclusions and made statements to the public and to the media about the fact that they think that already there is hard evidence to justify conclusions that there has been fraud on the part of Ingalls Shipbuilding; that intentionally management has somehow embarked upon a scheme of false charging. As a matter of fact, the description of this hearing this morning in the Washington Post talks about the fact that the hearing is being held to examine false charging schemes. We will see if the facts bear that out. If they do, this subcommittee needs to know about it.

I hope the witnesses will be helpful to the subcommittee in finding out the full truth about these allegations. They are serious, and I think it is with that frame of mind that we embark upon this hearing this morning. I appreciate very much, Mr. Chairman, your giving me the opportunity to make an opening statement.

Chairman **Roth**. Senator Bingaman.

Senator **Bingaman**. Thank you, Mr. Chairman. I have no opening statement. I am here to hear the testimony and obviously, as you pointed out, this is a general problem of the Government being overcharged or mischarged in connection with defense procurement. It is a concern of mine not only on this subcommittee but on the Armed Services Committee. So I look forward to the testimony.

Chairman ROTH. At this time, I would indeed like to welcome our good friend and colleague Senator Stennis who has played such an important role in the defense of this country, both as a Member of the U.S. Senate and, of course, as a leading member of the Armed Services Committee throughout the years.

Senator Stennis, would you care to make any comments?

Senator STENNIS. Thank you very much, Mr. Chairman. I deeply appreciate the courtesies of being here and sitting here at the membership table with you. It, incidentally, puts me in a place to hear better, but I do want to be heard briefly later in the hearing concerning vital industry, from a Navy standpoint, from my own standpoint, as Senator Cochran so well said. Many, many fine people work at this yard. I thank you very much, and I am going to be here all that I possibly can.

Chairman ROTH. Thank you, Senator Stennis.

At this time, we call forward Rodney Smith and David Glendinning, who are members of the subcommittee staff. I ask you gentlemen to stand and raise your right hands.

Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. SMITH. I do.

Mr. GLENDINNING. I do.

TESTIMONY OF RODNEY G. SMITH AND DAVID GLENDINNING, PERMANENT SUBCOMMITTEE ON INVESTIGATIONS STAFF COUNSELS

Chairman ROTH. Gentlemen, please be seated and proceed with your testimony.

Mr. SMITH. Mr. Chairman, members of the subcommittee, Senator Stennis, my name is Rodney Smith. I am deputy chief counsel of the subcommittee. With me is David Glendinning, subcommittee staff counsel. We have prepared a staff statement which we are submitting for the record and which I will summarize for you.[1]

The Committee on Governmental Affairs, of which we are a subcommittee, has recently devoted itself to queestions of defense procurement policy. In line with that, this subcommittee has taken a look at an actual site where that policy becomes practice.

The opportunity to take this look came in October 1982 when the Better Government Association, a private watchdog organization, made known to us a number of charges concerning Ingalls Shipbuilding in Pascagoula, Miss., a division of Litton Industries. The Better Government Association had taken a preliminary look, and on that basis, Chairman Roth ordered us to conduct our own thorough and independent investigation of the allegations.

We received the full cooperation of Ingalls in conducting this investigation, and though we focused on that company, indeed, our investigation could have been nationwide and industrywide.

In our investigation to date, this is what we found: Ingalls is a major defense contractor. It received approximately $780 million in defense obligations last year alone. It has just delivered to the U.S. Navy the U.S.S. *Ticonderoga*, CG-47, this country's first Aegis cruiser. It was hailed as ontime and onbudget. But the question remains, How does one get ontime and onbudget? One way is through hard work and good planning, and there is plenty of that at Ingalls Shipbuilding. But the pressure to be onbudget can also cause the demand to be met in another way, and that is mischarging. By mischarging, I mean the deliberate charging to one contract work performed on another contract. This can occur in a number of ways since there are regularly a number of contracts being worked on simultaneously in the yard, as this chart we prepared demonstrates. The heavy, black portions labeled indicate the duration of various contracts being performed on a timeline basis.

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[1] See p. 272 for the prepared staff statement of the Permanent Subcommittee on Investigations.

Ingalls Shipbuilding has an official policy against mischarging. The penalty can be loss of employment. However, in our investigation, based on examination of thousands of pages of documents and dozens of interviews, we found in Ingalls, like its primary customer the U.S. Navy, this practice has priorities which clash sharply with its formal rules.

At Ingalls, we found a number of examples in which the official policy against mischarging had been overcome by budget pressures of the type Admiral Rickover referred to when he wrote:

> By focusing too strongly on the so-called bottom-line results, corporate officials can generate pressures that cause subordinates to act in ways they would not consider proper in their personal affairs. Under pressure to meet assigned corporate profit objectives, subordinates sometimes overstep the bounds of propriety, even the law.

As I have said, mischarging can take a variety of forms. We found three of those varieties. I would like to tell you about them.

In the first instance, the first type is the charging of potential overruns on fixed-price contracts to cost-reimbursement-type contracts. This has happened recently at Ingalls when Navy cost-type contracts were charged for work performed on fixed-price commercial oil rigs. In the settlement of a recent lawsuit over the matter, Ingalls has admitted this occurred to the tune of $137,000.

The second form of mischarging that we found is the preplanned charging of time to fit available budgets instead of the work actually done. This was discovered not only by this subcommittee, but has repeatedly been found by Ingalls on audits as well as audits from the Defense Contract Audit Agency, which I will refer to as the DCAA.

The third, and gravest variety of mischarging we found is the deliberate charging to available low-priority budgets of work done on the CG-47, Ingalls' highest priority job over the last 4 years. I say the gravest instance for a number of reasons. First, in the context of the department in which it occurred, this scheme was massive. It covered up to 2½ years. It involved up to 20 percent of the manhours worked and, in the estimation of one participant, it may have involved over $1 million in labor charges, and it was planned.

In the words of one participant testifying under oath at a deposition taken by this subcommittee, and I quote:

> When the department totals were tabulated, my supervisor found out we were a number of heads over budget on the CG-47. He called a staff meeting and told all present that "I don't know who is over, but we must fix it." As the meeting broke up, I told him I had the time cards filled out and would have to change the time cards to fix it. He said do what it takes.

This deposition, and those of others of Ingalls' employees in this scheme, are submitted for the record as corrected, but not for republication.

This scheme was also serious in that the CG-47 was built under a cost-plus award fee contract in which Ingalls received awards, pure profit, because, in part, it was judged to be doing an effective job holding down costs. That the awards were based, in part, on this mischarging is a living example of the corruption of the procurement system by false data.

In every instance, the mischarging we found was done not for personal gain but to improve performance in the company's interest. The company's disciplinary policy as enforced seems to recognize this reality. Discharges were enforced if you would steal time and money from the company, but if you steal time from a customer, you are not only kept on, but you can still get a raise, although a reduced one. This happened in the oil rig mischarging case that I mentioned earlier.

Ingalls' internal auditors themselves recognized the pressure of budget on employees. They have told the company on at least one occasion that mischarging was occurring for budget pressure reasons, not of the participant's own making, and on occasion, the auditors themselves have succumbed to the pressure of budget, and on those occasions, they have refrained from recommending remedial action because it would cost the company money. This apologetic language is found repeatedly in the reports of mischarging that Ingalls' internal auditors had found. "The above finding would normally result in a recommendation to reclassify to indirect those employees performing functions recognized as indirect. It is recognized that to reclassify employees at this time would cause budget problems." That precise language is found in four Ingalls' internal audit reports during the months of March, April, and May 1981.

Whatever remedial steps Ingalls might wish to take are further hampered by a feeling on the part of employees that to come forward with such matters and bring it to management's attention is unwise. There is ample basis for that feeling, as you will hear later this morning. The problems we found are not solely with Ingalls Shipbuilding Division at all. The Navy, in its administration of the CG-47 contract, seems in many ways to have given a low priority to cost performance.

For example, only 15 percent of Ingalls' profit was based on an assessment of cost performance. Other considerations, such as technical performance, were given a much higher rating. There was no apparent input by the DCAA into decisions on profit awards. There were no records kept by the Navy from which we might see how these award determinations were made. We do know that the president of Ingalls sat in on all award session panel meetings and, in effect, cross-examined the Navy's representative. This at least suggests to us the Navy had little, if any, concern that the company might be manipulating data.

Finally, the Navy appears to have made no significant effort to remedy the numerous mischarging incidents consistently found by the DCAA. Indeed, there are some Navy officers who seem to feel there is plenty for everyone. They fitted out their ships with $14.000 leather sofas. $13.000 custom bookcases and carpet that ultimately cost $93 a yard by the time shopping trips to Dallas were added on.

With regard to the DCAA audits, we found that they did repeatedly detect mischarging on the company's part, and just as often, the company would respond with a promise to stop. Indeed, the same promissory paragraph is found in virtually every company response. But the mischarging went on and on despite the priority now said to have been given to audit followup by the Department of Defense and Inspector General, according to testimony before the full committee by Deputy Inspector General Vandershaaf.

Finally, we found, Mr. Chairman, that when DCAA does point out, as it occasionally does, that mischarging by Ingalls is destroying the credibility of cost data, it seems to concern no one. All parties—Ingalls, the Navy, DCAA—simply continue with business as usual. The Navy's investigative branch, the NIS, is of little help. They have one agent stationed in Pascagoula to cover over 10,000 Ingalls employees. They appear to have no substantial capability in the area of major fraud investigations. The agent stationed in Pascagoula regularly works side by side with Ingalls security personnel and only goes about the shipyard with the company's permission.

Finally, the taxpayers' ultimate protector is the Department of Justice. We found the Department to be essentially ineffective up to now. There have been very few cases brought successfully against major defense contractors. As regards Ingalls, the Justice Department in the last 5 years has brought two cases, one civil and one criminal. The civil case, in fact, was not initiated by the Department of Justice, but by a private citizen. The Justice Department stepped in and after 18 months of no visible action settled the case on the basis of information developed by this subcommittee.

The one criminal case brought against Ingalls was indicted in 1977. It was a major fraud case. It was dismissed just last month after 4 years of Department of Justice inaction. In dismissing the case, the judge found deliberate delay on the Justice Department's part and, in fact, the Justice Department attorney who argued the motion to dismiss admitted to the Court that the Department had no desire to proceed with the case during much of that period of delay.

In closing, the situation that we found is best described in the words of one participant in the cross-charging schemes:

"It's a case of too much money and too few checks on where it's going."

I would be pleased to answer any questions that you might have.

Chairman ROTH. In your opening statement, you made reference to three different types of mischarging. In the first case, as I understand it, it involved mischarging between private and Government contracts. Would you go into a little bit more detail what your investigation of the oil rig case found? As I understand it, Ingalls claimed less than $20,000 in mischarging. Why didn't the company auditors get the full story?

Mr. SMITH. As far as we could determine, Mr. Chairman, the $20,000 figure was put forward in response to the lawsuit that was filed by a former employee alleging this cross-charging from commercial oil rigs to Navy contracts. Ingalls performed its own audit and came up with this figure in the $20,000 range. That was their answer in their initial pleadings.

In our investigation, we were told by Ingalls that——

Chairman ROTH. What do you mean by Ingalls?

Mr. SMITH. By the shipbuilders, by the officials of Ingalls with whom we talked.

Chairman ROTH. What level?

Mr. SMITH. On the vice president, general-counsel level. That employees interviewed during this post-lawsuit audit simply had not come clean with the company. We talked with the auditors at Ingalls about what they learned, and they said they were not allowed to talk directly to the employees involved. That all questions had to go through the legal department.

Chairman ROTH. Ultimately how was the case settled?

Mr. SMITH. Ultimately the case was settled for $90,000 in cash payments and $47,000 in contract——

Chairman ROTH. $137,000 settlement based upon the subcommittee's investigation?

Mr. SMITH. That is what we were told by the general counsel of Ingalls Shipbuilding. As a matter of fact, the employee who initially unraveled the full extent—by the full extent, I mean the $137,000 scope—first came forward to the subcommittee and he was personally presented to Ingalls officials and they expressed their gratitude for helping them unravel the scheme.

Chairman ROTH. Ingalls has stated the roughly 15,000 hours mischarged in the piping department are but a tiny fraction of millions of hours billed by their entire work force during that period. What comment do you have to that?

Mr. SMITH. In terms of shear arithmetic that is accurate but in order to draw that ratio, one has to presume that all the remaining shops that comprise that 6 million figure are free of mischarges. In order to assume that, you have to ignore over two dozen DCAA and Ingalls audit reports in recent years pointing out that mischarging is a widespread practice.

Chairman ROTH. In other words, your investigation and the 15,000-hour figure involves just one department; it doesn't involve the entire plant?

Mr. SMITH. No, sir, it involves only the piping design department which is a small subdivision of the engineering division and, according to one of the participants in that department, the total hours mischarged might have made up 20 percent of the manhours worked during the period we were looking at.

Chairman ROTH. In your prepared statement, you used a figure of 30,000 hours as a maximum in the piping design shop scheme. The company has said to you in the past 10,000 to 15,000. How do you explain this discrepancy?

Mr. SMITH. The 30,000-hour figure is the maximum figure that can be calculated using the admissions made to the subcommittee staff in the sworn depositions of the participants. By taking the percentage estimations, the number of employees, the maximum period it may have gone on, 30,000 is the figure we arrived at. The company has used some different calculation and comes up with a figure in the 15,000 range.

There is obviously room for difference, but I would point out that the company's calculations of the oil rig scheme was initially $20,000 and multiplied by a factor of six by the time it was all out. So I don't know how much confidence I have in the 15,000 figure.

Chairman ROTH. What evidence do you have that some of the same kinds of practices of mischarging may have been occurring in other parts of the plant? What did the DCAA find in its analysis and audits?

Mr. SMITH. In a review of DCAA audits, beginning with the period of April 1975 forward, we found DCAA audits totaling 13 that discovered what we believed to be substantial mischarging problems. Those reports frequently contained such language as "24.5 percent of employees checked were mischarging, including arbitrary charging, to hulls not actually worked. Such charging to wrong contract has a potential annual cost of $573,000," just for the employees detected in the random floor check. That is a typical DCAA audit report.

I might add that we have interviewed in the course of this investigation present and past Ingalls employees who confirm that cross-charging was not limited to a particular section or particular department or particular period in time, but rather any time this budget pressure built up and a person was likely to succumb to the temptation to look good, you could have mischarging and frequently did.

Chairman ROTH. How recent were some of these reports made by DCAA?

Mr. SMITH. The most recent report we looked at was November 1982.

Chairman ROTH. What was the finding there?

Mr. SMITH. In that audit report, DCAA found out that a particular section was using what I have described as preplanned charging limits. The supervisors would send down to their line managers memorandums telling them this is how your people will be billed for the following month. I have submitted as an exhibit for the record a copy of memorandums. The company, I might add, has disputed that those memorandums were used in that fashion and has maintained, as have some participants whose jobs are in jeopardy if they admit cross-charging, these memorandums were for the purposes of planning and planning only.

We, the subcommittee staff, conducted an examination of payroll records, and these memorandums, and we found that during the months that participants admitted using the memorandums as directives, that the payroll records and the directive memorandums matched perfectly.

Chairman ROTH. In your prepared statement, you state Ingalls has not been successful in its promised efforts to put a stop to preplanned time charging. On what do you base this statement?

Mr. SMITH. In a number of company responses which were sought and obtained by DCAA in their investigations, the company promised to put a stop to certain practices. For example, with regard to the preplanned directives, we found that, I believe, in June 1981 and again in October 1981 DCAA found in random floor checks that these preplanned directives were being used in various locations. The company promised to put a stop to that particular practice and yet a year later it was detected again exactly in the same form.

Chairman ROTH. Have there been any similar findings of mischarging on the part of Ingalls internal audits?

Mr. SMITH. Yes, Ingalls provided to the GAO, whose representatives were working on our behalf in recent weeks, their internal audit reports going back to 1977. In those reports, we found a number of cases where Ingalls' auditors found substantial problems with mischarging of the type I described.

Chairman ROTH. Can you review what some of these findings were?

[At this point, Senator Nunn entered the hearing room.]

Mr. SMITH. For example, in November 1980, their auditors found that Ingalls' supervisors were mischarging "to make up time from a week before." They found that mischarging was a growing trend and the auditors recommended that the company call the individuals in and tell them to stop it. That was the only recommendation.

Again in May 1981, their auditors found predirected mischarges by memorandums. The auditor's response was that the employees involved should be reclassified to avoid that, but that to reclassify the employees would cause the company budget problems. That was the end of the recommendation.

Chairman ROTH. Then didn't four different internal audits make similar findings, that above findings would normally result in a recommendation to reclassify to indirect those employees performing functions recognized as indirect. Then the key language is "It is recognized that to reclassify employees at this time would create budget problems."

Mr. SMITH. Yes, sir, virtually identical language is found concluding internal audit reports in March 25, 1981; March 9, 1981; April 9, 1981; and May 1, 1981.

Chairman ROTH. Explain what that means, "It is recognized to reclassify employees at this time would create budget problems." Am I correct they made a finding that people were improperly classified and that they should have been classified indirect?

Mr. SMITH. That's correct.

Chairman ROTH. This is on the part of an internal audit on the part of Ingalls?

Mr. SMITH. Yes, sir.

Chairman ROTH. The importance of that finding is indirect is spread against all Government work.

Mr. SMITH. That is part of the significance; yes.

[At this point, Senator Nunn withdrew from the hearing room.]

Chairman ROTH. They say that to reclassify would create budget problems. What was meant by that language?

Mr. SMITH. From what I can deduce, not having talked to the auditors who wrote it, this seems to suggest that, first, employees are working in a direct category when they are actually performing functions that should be categorized and charged as indirect.

To charge direct means that in a Government contract, the builder is reimbursed dollar for dollar for the cost of that labor. If the employees are categorized as indirect, only a portion of the dollar, depending on what part of his labor is devoted to Government activities, is recoverable. An employee working in an indirect function being charged to a direct budget is being overcharged by the difference between what he would receive as an indirect employee and what he is receiving as a direct. Thus, when the auditors explained this situation, they were saying that the Government was being overcharged and the case of these employees were being billed as direct. We ought to fix it but if we fix it, it is going to mess up the budget, so let's not fix it.

Chairman ROTH. What do you mean by "mess up the budget"?

Mr. SMITH. It means those employees who have been paid out of a direct budget could, first, no longer be paid, and second, if full remedial action is taken, some portion of that direct cost should be reimbursed to the Government because it paid for something it didn't get.

Chairman ROTH. Going back, again, to the internal audit of Ingalls on June 30, 1982, what was the finding in that audit?

[At this point, Senator Nunn entered the hearing room.]

Mr. SMITH. This audit was of a matter of particular concern to the staff because in June 1982, the DCAA auditors swept into the cost center, the shop, the piping design shop where this massive cross-charging scheme was taking place, they swept in at the close of what we consider the peak period of mischarging and yet they gave the shop a clean bill of health. They didn't find a single thing. This reinforced something we had heard from other employees, and that is, it is fairly easy to hoodwink DCAA auditors.

In more than one instance, we found employees admitting acting on instructions from supervisors, they kept a separate drawing on the board just in case the auditors showed up. That drawing would match the charging data to which the person being charged was not actually working.

Chairman ROTH. In the June 30, 1982 audit, the internal audit also finds that in the engineering design division—whatever its name was—that there was charging according to budget.

Mr. SMITH. Yes, sir; in another audit, they found what has been found repeatedly that managers would simply take the available budget that was given to them and allocate the hours according to budget rather than according to what the employees were actually working. There might have been some occasions when that system resulted in the right charges, just as a broken clock is right twice a day, but it was purely accidental.

Chairman ROTH. In other words, in an internal audit as late as last summer, June 1982, was continued to find instances where the auditors did find that charges were being made not based on hours actually worked but according to budget requirements?

Mr. SMITH. According to the budget availability, that's right.

Chairman ROTH. Mr. Glendinning, could you elaborate on what the NIS investigator does? You say they only have one man there?

Mr. GLENDINNING. Yes, sir, the Naval Investigative Service is charged with investigating criminal, fraud, and counterintelligence matters for the Department of the Navy. Their responsibilities include investigating internal Navy problems as well as administrative investigations on behalf of the Navy for contract fraud, procurement irregularities, and things like that.

They have one agent assigned to the Ingalls Shipbuilding facility. He has been there approximately a year and a half.

Chairman ROTH. Let me ask one further question. What is the company policy on improper timecards?

Mr. SMITH. It is punishable by official company policy. In fact, it can be punished, as I said by loss of job. The company provided us with statistics. I am not certain the year in which they began, but they reported over 150 cases of mischarging detected. I believe 66 employees discharged and 99 employees otherwise disciplined. However, in conversations with company officials, they confirmed that the great bulk of those cases, particularly those cases involving discharges, were cases of individuals falsifying their own timecards or the timecards of a friend or coworker, such as punching out the timecard of a friend who is absent. The company confirmed for us in terms of cross-charging for budget reasons, such as we have described in these instances, no employee has been discharged in the company's corporate memory.

Chairman ROTH. What authority does—I think it's the Director of Audit. That is not his technical name, but the top auditor. What authority does the top auditor have in initiating action based on the findings of the audit division? Does he have any authority to take corrective action?

Mr. SMITH. I don't believe he does. More concern to us was his statement that he has no authority to followup audits to see that any recommendations the internal auditors might make are, in fact, followed through. He has no such authority.

Chairman ROTH. He advised you he has no authority to follow through on the basis of these auditors?

Mr. SMITH. That is right, he has no authority to see that his recommendations are implemented. As I said, in some cases such as the oil rig case, the auditors are not even permitted to talk to the employees involved but have to go through the legal department.

Chairman ROTH. What disciplinary action was taken in the case of the oil rig? That was the case where they charged hours devoted to private contract oil rigs to Government contracts. What action was taken against the engineers involved in that action?

Mr. SMITH. The employees who initially admitted charging oil rig work to Navy contracts admitted it only in the amount of $20,000 or less. For those admissions, the employees involved who admitted this preplanned scheme had their merit increases they were due that year, which would have been 11 percent of their annual salary, reduced to 6 percent. They continued in their managerial positions and, in fact, got 6 percent raises for that year.

Chairman ROTH. Does the Government admit they were paying for hours not performed or labor not worked for Government contracts?

Mr. SMITH. Ingalls admits that the Navy paid for work it didn't get.

Chairman ROTH. Senator Cochran.

Senator COCHRAN. Thank you, Mr. Chairman. During the course of your investigation at Pascagoula, tell me about the nature of the cooperation, the extent of it, if any, that was given to our staff by Ingalls management?

Mr. SMITH. The cooperation received at Ingalls was full and absolute. In some cases, because of situations that arose, time limitations, we had to make requests that were urgent and they were always met, in my opinion, to the best of the company's ability.

We dealt regularly with the general counsel of Ingalls Shipbuilding. We found him to be candid, able and eager to cooperate with this subcommittee on behalf of the company. They provided us access to all records that we requested. They arranged for interviews of all employees that we requested, current employees.

Senator COCHRAN. At any time, did you get the impression that Ingalls' management was trying to cover up or hide anything from the investigative staff?

Mr. SMITH. No, sir.

Senator COCHRAN. Tell me this, have you had an opportunity to look at the operation or the way of doing business of any other shipyards around the country?

Mr. SMITH. In the course of this investigation, we developed some evidence along the way that there were practices worth scrutiny at other yards. We have not begun a full-blown investigation, such as we conducted in Pascagoula.

Senator COCHRAN. Has there been any effort to discuss with the subcommittee the possibility of expanding this inquiry to include practices at other yards if there is indication there is an industrywide problem?

Mr. SMITH. Yes, sir, that is under consideration right now.

Senator COCHRAN. I don't want you to disclose at this time where you have reason to believe that other such practices of difficulties with allocating time to contracts might be present, but I would hope the subcommittee would give careful consideration to expanding the scope of the inquiry and not simply single out one yard for careful scrutiny and presume we have done our job. I think it may be incumbent upon the subcommittee to consider expanding the scope of the inquiry. As the chairman stated in his opening statement, the weakness is inherent in the system.

Chairman ROTH. Would the Senator yield?

Senator COCHRAN. I will be happy to yield.

Chairman ROTH. I would assure the Senator from Mississippi that it is the intent of the subcommittee to look at the practices elsewhere. That is what we are really concerned with, how widespread and what needs to be done to try to remedy the situation. As a general reference, I would just point out that this approach, looking at one organization, is not unique.

For example, in the case of our investigation of unions, it has been our practice to concentrate on one particular union before we move on to another. We are currently making an indepth investigation of the Hotel Workers. Earlier under the stewardship of Senator Nunn, we looked at Teamsters. Unfortunately, we have to move step by step, but it is the intent not to single out any one particular organization but to try to look at the general practices within the defense industry.

Senator COCHRAN. Is there any suggestion that you are making to the subcommittee that the mischarging is an intentional effort on the part of Ingalls' management to defraud the Government?

Mr. SMITH. If by Ingalls' management you mean the very top levels of the company, no, sir. The problem becomes the definition of management. If you are a line employee in the shop, to you management is the next guy up the ladder. There are four, five, six, seven steps, rungs in that ladder. Where management's conscious manipulation begins and ends is a very, very difficult matter to determine. But a short answer to your question is, if you mean the top level management, no, we found no evidence it is a matter of conscious design on their part.

Senator COCHRAN. Apparently with 10,000 or so employees, a company like Ingalls, any other shipyard, attempting to manage the work and allocate the time of all employees is faced with a very challenging undertaking.

Did you find that to be the case, that it is a complex matter and one not easily managed perfectly?

Mr. SMITH. I would have no difficulty agreeing with that proposition at all. I might add, having never seen a shipyard before, our visit to the yard—repeated visits—we found to be an awesome undertaking and impressive.

Senator COCHRAN. Even the determination of when to allocate time as directs time or indirect time; that is, whether it is to be identified as part of a general overhead of a yard or whether it is work done specifically for a specific contract is in itself a very difficult decision to make even if all of the facts were known by the person making that decision; is that correct?

Mr. SMITH. As a matter of theory, that is certainly correct. It is a judgment call on the part of any manager who has to determine what type of work his employees are performing. In the instances I have cited where the auditors were quite firm in finding that people were misclassified, it seemed that the managers were well aware of what they were doing.

Senator COCHRAN. Isn't it true, too, in 1981, September 1981, that Ingalls' management, as a result of its own internal audits in an effort to make sure accuracies were the rule and not the exception, reclassified some 500 employees? Did your investigation cover that?

Mr. SMITH. I am not familiar with the specific figure, but I do know periodic reclassifications have taken place. Indeed, in response to one internal audit report we examined, I know there were 149 engineers reclassified. However, as to what they might have cost the Government up to the point of reclassification was not discussed, and I am not aware of any recovery on that.

Senator COCHRAN. In the discussions that you had with officials at Ingalls with whom you communicated during the course of the investigation, were you furnished voluntarily information that you didn't even ask for that helped expand your degree of understanding of how business was transacted, how records were kept? In other words, did Ingalls undertake on its own to actually get involved in the investigation side-by-side with you to help produce for you information that you might not otherwise have been able to obtain?

Mr. SMITH. Yes.

Senator COCHRAN. I have no other questions.

Chairman ROTH. Senator Bingaman.

Senator BINGAMAN. Let me ask a couple of questions here, Mr. Smith. At one point in your testimony, you said the DCAA investigators were hoodwinked into believing nothing was going wrong, when, in fact, something was wrong. I think you cited a date, June 30, 1982, when DCAA auditors swept in and found nothing in a situation where they should have found a great deal; is that accurate?

Mr. **Smith**. It is accurate, Senator, except for the date. That may be a misprint. Yes, in the Cost Center 555 in redesign, there was an audit during the period this cross-charging that has been admitted and DCAA gave them a clean bill of health.

Senator **Bingaman**. Do you think one of the problems we may be facing, one of the reasons why this cross-charging is taking place and not being stopped, is the incompetence of the auditors that DCAA is assigning to these jobs; is that your conclusion?

Mr. **Smith**. It is our conclusion that DCAA is regularly ineffective because of problems in the design of their checks. I don't want to say they are incompetent because we are fortunate in having the assistance of DCAA in various checks we have performed.

We found on an individual basis they were able, eager and altogether fit public servants. However, they conducted their investigations regularly in a manner that lent themselves to being ineffective. They would make a floor check, and in making a floor check, they would check in with the boss' office, tell them what they were going to do and go down to the shop. A phone call had preceded them. Anything that went on, they were not going to detect in that shop.

As I said, there were other shops where employees were instructed to keep a piece of work on their drawing boards to match the job to which they were being charged so if a DCAA auditor says, "What are you working on?" "I am working on this drawing," and it matched the chart.

Finally, we found in timecard inspections, DCAA frequently would ask an employee what are you working on? They would know his answer on Tuesday or Wednesday and come back on Friday and pick up his timecard and compare it to his answer. By Friday, the timecard matched the answer.

Senator **Bingaman**. Am I right that the other investigative agency with responsibility to uncover this type of a problem would be the Naval Investigative Service? Is that the other agency you identified that should be detecting these problems?

Mr. **Smith**. That is one of them; yes.

Senator **Bingaman**. In your opinion, how well are they performing? I know you indicated they only have a single person assigned. Is he or she doing the job they are supposed to do?

Mr. **Glendinning**. Sir, we have had conversations with the agent down there at Pascagoula and he emphasized to us he does not have an informant network within the Ingalls employee group. He does not have the opportunity to walk freely around the yard because he feels that the yard belongs to the company and they can throw him out at any time if they don't like what he is doing.

He emphasized to us also that he has many responsibilities down there, not just in the fraud area, but he has criminal investigations that need to be accomplished against naval personnel and just doesn't have the time to do everything.

Senator **Bingaman**. So your basic conclusion is the Naval Investigative Service is completely incapable of doing the job that needs to be done with their present staffing?

Mr. GLENDINNING. They have conducted a few criminal investigations, but they just don't seem to be able to do the whole job.

[At this point, Senator Cochran withdrew from the hearing room.]

Senator BINGAMAN. Mr. Smith, you said there were other agencies as well that had responsibility for detecting this type of mischarging. What agencies are those?

Mr. SMITH. Certainly the FBI has jurisdiction over fraud on the Government.

Senator BINGAMAN. To your knowledge, has the FBI shown any interest in this type of investigation at this shipyard or any other?

Mr. SMITH. The only substantial investigation I am aware of by the FBI resulted in a number of arrests and indictments, I believe, in 1978 for fraud on both the company and the Government in the purchase of material. But in examining the 500-page file of the Bureau, I found that every interview was conducted by the FBI with an Ingalls' security person at his side. The extent to which an employee might be inclined to give up any matters of company policy with a company representative sitting there I think is not good.

Senator BINGAMAN. So your conclusion is that the FBI, to the extent they have shown interest in this area, really does not do a competent job either; is that accurate?

Mr. SMITH. That's correct.

Senator BINGAMAN. Are there any other agencies you feel have responsibility here?

Mr. SMITH. With regard to the trial of cases, certainly the Department of Justice——

Senator BINGAMAN. Just investigating, first of all.

Mr. SMITH. I think DCAA, NIS, and FBI just about covers the field.

Senator BINGAMAN. On the DCAA work, you indicated there were 13 audit reports by DCAA in which they indicated substantial mischarging, in this particular shipyard, is that accurate?

Mr. SMITH. That is correct, in the period we examined since April 1975.

Senator BINGAMAN. What happens to those audit reports? Where do they go for a followup, either by civil suit or by criminal prosecution?

Mr. SMITH. They go to the Navy's contract officer who is the point of contact with the company for his consideration and implementation into the contract administration. For example, by that I mean, if a substantial and specific mischarge has been found, it is referred to the contract officer who may then consider and pursue recovery of that amount in the course of administering the contract.

Senator BINGAMAN. And then if they decide to do that, they turn it over to the Justice Department; is that the way it works?

Mr. SMITH. No, sir, if it is limited to the contract officer, it may take place and be remedied within the limits of the contract administration, that is between the Navy and the contractor because these contracts go on for a period of years. It is a matter of you owe me some money; I will get it out of the next payment.

[At this point, Senator Cochran entered the hearing room.]

Mr. SMITH. However, we found very, very few such instances in the administration of the CG-47. We found no instance where the award panel, which was giving the contractor its fee based on the grade and assessment of its performance, we found no instance where the DCAA had input into that determination. We found no instance when the award panel made a specific request of DCAA to look into a certain matter. They simply didn't play a role.

Senator BINGAMAN. So on the 13 audit reports the DCAA did with regard to this mischarging in this particular shipyard, to your knowledge, was there any end result coming out of any of those?

Mr. SMITH. In some instances, yes. As I have said, in one instance, at least 149 engineering department personnel were reclassified from direct to indirect. I am not aware of any monetary recovery by the Government and, in most cases, I am not aware of any remedial action promised by the company except they would give the involved employees a lecture on the importance of proper timekeeping.

Senator BINGAMAN. What is the amount of money we would be talking about had each of those 13 reports been determined to be accurate and they had been followed through to a monetary recovery from the company?

Mr. SMITH. I can't give you a total figure for all 13 because some of them do not suggest the extent of monetary loss, but in just a few of these, one of them, one of them projects a potential annual impact of $3 million. Another projects an annual impact of one-half a million dollars just for the employees detected in the random floor check, not even for the entire shop.

Senator BINGAMAN. So you feel there is a substantial amount of money that could have been recovered as a result of these 13 audit reports had they been properly pursued to a conclusion?

Mr. SMITH. Yes, sir, I certainly do.

Senator BINGAMAN. And where did the system break down in pursuing those to a conclusion?

Mr. SMITH. It is difficult to put your finger on a specific location because it gets into the question of one's motive for failing to take further action, but as far as we can tell in the question of the DCAA audit, they went to the Navy, the contract officer who had the responsibility for being a steward of taxpayers' funds, but he also had the duty to see the Navy got the most effective ship it could and as fast as it could. For those reasons, I think, those conflicting reasons, the cost effectiveness priority went down to the bottom of the list.

[At this point, Senator Percy entered the hearing room.]

Senator BINGAMAN. So you are saying the system broke down with the naval contracting officer?

Mr. SMITH. That's our assessment.

Senator BINGAMAN. That's all the questions I have, Mr. Chairman. Thank you.

Chairman ROTH. Thank you Senator Bingaman. Senator Nunn.

Senator Nunn. Thank you, Mr. Chairman. Mr. Smith, it seems to me, we have four or five different groups here, that are involved in this one way or the other. Senator Bingaman was pursuing this line of questioning. You have the DCAA. That is Defense Contract Audit Agency?

Mr. SMITH. Yes, sir.

Senator NUNN. Are they the first line of audit or second line behind the Navy?

Mr. SMITH. They are the Government's auditors on the spot.

Senator NUNN. There are no Navy auditors as such; these are defense auditors?

Mr. SMITH. There is a Defense Audit Agency, I believe, but we did not have contact with them——

Senator NUNN. You mean Navy audit. Is there a Navy——

Mr. GLENDINNING. Sir, there is a Navy Audit Service that conducts periodic checks of management of the shipyard by the supervisor of shipbuilding. The Defense Contract Audit Agency goes to the contract costs, their provisions and how our money is being spent on a daily basis.

Senator NUNN. What is the Naval Investigative Service? That is not an audit service?

Mr. GLENDINNING. They are special agent investigators.

Senator NUNN. You said there was only one representative of that outfit there?

Mr. GLENDINNING. Yes, sir.

Senator NUNN. How about the Navy contracting officer, how many of those are normally involved at a shipyard of this size?

Mr. GLENDINNING. Sir, at Ingalls on the Navy side, there are a total of 412 contracting personnel. In the contracts department, there are 37.

Senator NUNN. You are talking about on the Ingalls side?

Mr. GLENDINNING. No, sir, these are Navy employees.

Senator NUNN. How many of them?

Mr. GLENDINNING. There are 37 people assigned to the contracts department.

Senator NUNN. Down there on location?

Mr. GLENDINNING. Yes, sir.

Senator NUNN. Thirty-seven people?

Mr. GLENDINNING. Yes, sir.

Senator NUNN. You said 400 something.

Mr. GLENDINNING. There are 412 total people involved in contracting for the Navy.

Senator NUNN. At that location?

Mr. GLENDINNING. At that location.

Senator NUNN. What was the 37?

Mr. GLENDINNING. The 37 is in the contracts department specifically.

Senator NUNN. What are the other 400?

Mr. GLENDINNING. Sir, I believe they work around the yard overseeing the work.

Senator NUNN. Do they have anything to do with looking at timecards, 400-some people; is that part of their jurisdiction?

Mr. GLENDINNING. No, sir, they don't perform audits. They are there to oversee the work of the contracts.

Senator NUNN. Just the quality of the work?

Mr. GLENDINNING. Yes, sir.

Senator NUNN. If they come across something, though, they would certainly be under duty to point it out?

Mr. GLENDINNING. Yes, sir.

Senator NUNN. You have the DCAA, Naval Investigative Service, the contracting offices, the Ingalls people themselves. Let's look at Ingalls for a minute.

As I understand your answer to Senator Cochran's question, you said you didn't find any high level management involvement in this?

Mr. GLENDINNING. That's correct.

Senator NUNN. So there is no allegation against high level management in the company?

Mr. GLENDINNING. There are none.

Senator NUNN. What do you define as high level? How high up did this malfeasance go, if that is what we could call it?

Mr. SMITH. In the instance of the Piping Design Shop, which we pursued in greatest detail, we found that the conscious manipulation of charging occurred at the employee level, the first line management level, the second line management level.

Senator NUNN. Let's take the chairman of the board. What line do you call him? You say first line, second line; where is the chairman of the board and where is the president in that kind of analysis?

Mr. SMITH. Senator, I was actually starting from the other end of the ladder from the employee. There is the line employee.

Senator NUNN. Right.

Mr. SMITH. There is at least in the shops we studied—there may well be other shop designs—but in the shops we studied, there are line employees; there are section managers above them; there are group managers above them; there are department managers above them; there is a level of management above them; there is at least a director level above that, and I would say there must be seven or eight levels of management up to the top level by which we mean president and vice president.

Senator NUNN. Let's say a total of eight levels of management starting with one and two.

Mr. SMITH. I would think it is at least that number; yes.

Senator NUNN. Let's say eight, just for the purposes of example. The highest you were able to get to in terms of your investigation is the second level out of eight; in that right?

Mr. SMITH. The first level being the first level above ordinary employee. That level and the level above it admitted the calculated manipulation of time. The last level up that admitted it also and implicated the next level up. That level manager has denied his involvement. There the line is drawn.

Senator NUNN. So there is admission at level 1, admission at level 2, allegation against level 3, and denied at level 3, and you were never able to trace it farther up the line than level 2 and an allegation at level 3?

Mr. SMITH. No, sir; we haven't pursued it beyond that.

Senator NUNN. Let's take that, then, as far as the Ingalls people are concerned. What lessons should this shipyard and its top management learn from this? What would you advise Ingalls to do that they did not do during the course of this malfeasance, the top level people?

Mr. SMITH. The biggest problem we found was that the line employees and first line and second line managers, who make up the bulk of the personnel on that yard, are aware of their jobs only in the day-to-day sense of mission accomplishment. They are not aware of the technicalities of budget administration or of the ramifications of mischarging. Indeed, many of them are not even aware they are mischarging because it is all in codes they don't pay much attention to.

The biggest problem management has, in our opinion, based on 6 months of investigation, is, first, they need to make employees well aware, as we are, of the serious implications of cross-charging, that it is not all right to simplify and say it all comes out of one pocket, it doesn't matter, it all comes out in the wash. That is not the case.

Second, the company needs to pursue an aggressive policy of demonstrating to employees that stealing from customers—stealing time and stealing from customers is a serious offense and punishable just as stealing 4 hours of labor from the company, as in walking out of the shop early is a serious matter.

We have at least one case we studied where an employee was fired for 4 hours of unauthorized absence, and yet these employees who charged, by their first admission, $16,000 from a customer.

Senator NUNN. $16,000 or hours?

Mr. SMITH. $16,000 in the oil rig case. That was their initial admission. They got raises then, but if you take 4 hours from the company, you can be fired. That, I would say, is turning the thing on its head.

Senator NUNN. Are you saying, then, that the main thing Ingalls needs to learn from this and, for that matter, other shipyards, is they need an intensive educational campaign down to the first and second tier of management that is absent so far?

Mr. SMITH. An intensive educational campaign backed up by an intensive disciplinary campaign and awareness on management's part that it is held responsible even if there are three or four layers between it and the people actually conducting these matters, that management has the responsibility for seeing that business is done properly.

As Admiral Rickover pointed out, it is the budget pressures that cause these line managers and employees to go wrong, and the budget pressure comes from on high.

Senator NUNN. How are you going to get rid of that budget pressure? You are almost saying you have to reverse the law of economics if you want to get rid of budget pressure.

Mr. SMITH. I don't think, Senator, we will ever get rid of budget pressure and perhaps not if we want to get the best ships out as quickly as possible. The question is, how firmly and sharply are the lines of propriety going to be drawn so that when the employee who is pushed by those pressures when he approaches the border will be able to see it sharply and clearly.

Senator NUNN. Let's look at the Navy for a minute. What lessons should the U.S. Navy learn from this? If you were the Secretary of the Navy right now and with the knowledge you have had after having done an investigation here, what would you change?

Mr. SMITH. I would make my personnel aware that we are naval officers responsible for the national defense and responsible for the best weapons we can put out to sea, but above that, we are American naval officers who work for the taxpayer and spend his money, and we can't forget that fact in buying those ships.

Senator NUNN. Do you think that has not been done in the Navy?

Mr. SMITH. In the administration of this CG-47 budget, I think it is fair to say, based on what we have seen, that cost effectiveness was given a low priority.

Senator NUNN. Do you believe that is true throughout Navy shipbuilding that cost effectiveness is at the bottom of the totem pole in terms of priority of the Navy?

Mr. SMITH. No, sir, I can't say that is a uniform situation.

Senator NUNN. Is that the situation in this particular case?

Mr. SMITH. Yes, sir.

Senator NUNN. How do you arrive at that conclusion, from discussion with Naval officers?

Mr. SMITH. It is from discussion with Naval officers involved, with the contracting personnel involved. It is from the examination of the Navy's own statement concerning its administration of the CG–47 contract, although the contract itself omitted numerical weightings to be given to various criteria for evaluation. The report now issued by the Navy says, and you will find it as a chart in Ingalls' prepared statement for this hearing, that cost effectiveness was only 15 percent, given a 15-percent weight among all the criteria considered in this particular contract.

Senator NUNN. You are saying criteria. Is that criteria by which you judge the contract price, or is that just criteria by which you evaluate, if you are the Secretary of the Navy or someone down the line, the performance of the Naval contracting officials? What is the result of this criteria?

Mr. SMITH. It is criteria by which the award panel judges the contractor's performance and gives him his profit on the basis of that performance over the life of this contract.

Senator NUNN. Is that a standard Navy practice to give cost effectiveness only 15 percent of the overall scale, or is this an exception in this case with these ships?

Mr. SMITH. The CG–47 is the first instance this contract form has been used to purchase a ship, I believe. So when you talk about a history, you are talking at a very short period of time. However, there are other CG–47 class ships under contract, cost plus award fee contracts, in which the criteria are weighted.

There are no other contracts in which cost performance is given such a low rating. In some of the follow-on contracts, cost performance is 40 to 45 percent of the assessment criteria.

Senator NUNN. What you are saying is, neither the contractor nor the Navy personnel involved had the proper incentive in terms of cost effectiveness, and that came from the very nature of the contract itself and the rating for judging it; is that right?

Mr. SMITH. To the extent those individuals felt their incentive was in the contract priority and weighting, that low priority certainly would have—yes.

Senator NUNN. Did anybody ask why that was done in higher management of the Navy; why that was given such a low priority in this case; why cost effectiveness was only 15 percent?

Mr. SMITH. Yes, the Navy's position is this is the first ship of its type, first ship of the class. It is the first time the Aegis weapon system has been put to sea. It is a very highly sophisticated system, the wave of the future and, therefore, as the first ship of the class, certainly technical and performance in the Navy's opinion should be given top priority, and it was.

Senator **Nunn**. These people in the first and second rung who shifted hours between jobs, in their minds were they doing something that was wrong in a criminal sense? What was their motivation, as you judge it, after interviewing them?

Mr. **Smith**. I am not certain any one of them thought in criminal terms, but certainly a number of them, all of them knew it was improper. They knew they were charging a customer for something they weren't getting and falsifying data. In fact, they had conversations about it in which one said to another, this is wrong; we are going to get in trouble; we are going to get caught one of these days.

Senator **Nunn**. Did that indicate to you they did not believe management up top would condone it or in the conversations and interviews did you get the idea you felt they were doing something that top management in Ingalls would really approve of? In other words, on whose behalf were they acting organizationwise?

Mr. **Smith**. There is no question they were acting first on their behalf in terms of turning in a performance the company would approve of and give them a better raise. But I would say our assessment is that they were caught in a situation where they were well aware that they were risking punishment because they were violating a formal company policy against time charges.

However, they also knew they were under intense pressure to perform under the budget, and in weighing those two pressures, budget prevailed, as it so often does.

Senator **Nunn**. So you are saying why you can't remove and probably should not remove the budget pressures, the company should instill a higher priority in honesty and ethics than the budget pressures themselves; is that right?

Mr. **Smith**. That's right.

Senator **Nunn**. And you are saying that hasn't been done?

Mr. **Smith**. Certainly in these instances where this type of conduct has been done, that is right.

Senator **Nunn**. Mr. Chairman, I have other questions, but I know my time is probably up.

Chairman **Roth**. Senator Percy.

Senator **Percy**. Mr. Chairman, I just have one question, but I would like to take a moment to make an opening statement and ask that it be placed ahead of the questioning period.

Chairman **Roth**. Please proceed.

OPENING STATEMENT OF SENATOR PERCY

Senator **Percy**. I know in convening this hearing today that our own staffs have done a tremendous amount of work, both minority and majority. Because of the seriousness of the situation, I had an unusual Sunday meeting at my home when I came back from Chicago to thoroughly go over this issue with the investigators to be certain the allegations that were being made have substantiation behind them.

What has been alleged about certain practices of employees at Ingalls Shipbuilding is very disturbing, indeed. I say that in the light of having spent several years in charge of all defense contracting for a major multinational corporation years ago, and then having spent 3 years as procurement officer in the U.S. Navy, a year of it right down here in the Ordnance Department in the Naval Air Corps in Washington during World War II, I am somewhat familiar with the practices, both from an industrial standpoint and from the Navy buying standpoint.

At today's hearing, we are going to try to get to the bottom of some of the problems that have been revealed and have already been demonstrated by our own staff, by Rodney Smith and his investigators. I don't think our task must be looked upon as just to identify problems, but our task, as Senator Nunn's line of questioning, and your own, Mr. Chairman, pointed out, is to try to work toward a fair and effective solution to these problems.

Many of the problems we will hear about today result from a system that, in my judgment, allows, and even sometimes encourages, abuses. Recent press attention has focused on mischarging on Government contracts and extravagant expenditures to outfit Navy ships. The chairman has mentioned these issues in his statement and our serious concern about them. I would like to draw attention to two additional issues which the Better Government Association will bring to light when it presents testimony this morning.

First, the BGA will explain how the Navy, through what is called a basic ordering agreement, or a BOA, paid $256 for a spare part allegedly costing Ingalls Shipbuilding just $11 to buy. If it is true, this is better, than a 2,000-percent markup. I was never able to mark up anything that much. Here is the part. It is called a gravity timer switch. This switch was not urgently needed by the Navy. The BGA ordered the same switch just by ordering it by mail and they paid, and I have a check to certify it, $12 for this part.

As the BGA will testify, this is not an isolated case when it comes to these basic ordering agreements. That is the system we want to get back at. It is a repeat of history. My predecessor in the Senate, Paul Douglass, used to constantly go out and buy hardware store items at a fraction of the cost that military services were paying under negotiated contracts with contractors. And the average person who goes to hardware stores would wonder why is it possible to go to a hardware store and buy it cheaper than the Navy can buy it in quantity and with the power they have with their purchasing clout.

Additionally, BGA alleges the Navy, in particular, has problems with the disappearance of parts and supplies. For example, the BGA visited a junkyard in Mississippi and purchased an unused valve still in its original packing crate which the Navy allegedly purchased and then discarded. Although the BGA bought the valve for $70, its book value, according to Navy officials, was $6,500.

From what I understand, these are not hard items to manufacture. The machine tool industry in Illinois is quite versatile and I have no doubts dozens of companies in our State and States represented by our Senators on the committee here would be eager to compete on some of the spare parts business generated by the defense buildup. Maybe it is time to bring a little more competition into the spare parts business. The American public, I think, wants a strong national defense, but they are really outraged when they see week after week on 20/20, 60 Minutes, whatever it may be, indications of extravagance.

It is our job now to see whether or not that investigation that has gone forth before the American public can be verified by private investigation and can stand the light of day, and we want to give time and attention to the contractors themselves to come forward and say whether or not allegations made against them are fair.

I do want to tell my fellow members of the subcommittee that a man I respect and revere above all in the Senate for his integrity and decency, former chairman for many years of our Senators' prayer breakfast, John Stennis, has called me, as I am sure he called you, Mr. Chairman, to simply certify he has never known two finer people than the chairman of the board of Litton Industries and the president of Ingalls Shipbuilding. I have had the pleasure of meeting with Fred O'Green, the chairman of Litton. He seems to be an outstanding industrialist, and I know myself I have had to stand as head of the company for practices that go on down the line.

In that connection, I think Senator Nunn's line of questioning is very important: At what level did this occur, and was remedial action then taken by the company? That is really all we can ask. So my one question goes to this. One of the crucial questions in the investigation of cross-charging is whether this practice was orchestrated at lower management levels at Ingalls Shipbuilding as management says, or at higher levels of management as was implied by a television program? If top management knew of or directed cross-charging, we have a much more serious situation, of course.

I want to ask our witness today from the subcommittee investigating staff, based on your own subcommittee investigation, do you have any evidence whatsoever from any of the people you talked to that top management—top management—the heads of the company—actually had knowledge of and countenanced cross-charging as a practice, or did it go totally contrary to the published code of ethics of the company, as I have been led to believe, and as I do believe was the company policy? Do you have any knowledge that Ingalls' employees were actually fired only as a result of their willingness to talk to investigators?

Mr. SMITH. First, we have no evidence as a result of this investigation upon which we are prepared to say top level management—by that I mean president, vice president level—orchestrated, countenanced or otherwise planned or participated in cross-charging.

As I described it, the system involved first line employees, second line, perhaps third line managers. However, to the extent that occurred because of budget pressure being exerted in such a way that it would cause these employees to violate the stated policy, then certainly management needs to take a hard look at the extent to which its budget pressure overcomes its stated policy.

Senator PERCY. But the policy of the company was clear that they would not tolerate such actions, and it is only indirectly the breakdown of character of the individuals involved in their striving for a bonus, possibly based on budget performance, which they would not meet other than through these practices?

Mr. SMITH. That's true, it is violation of stated company policy.

Senator PERCY. I thank you very much.

Senator COCHRAN. Would the Senator yield?

Senator PERCY. I will be happy to.

Senator COCHRAN. He asked a second question which I don't think got a response. Were any employees at Ingalls dismissed or disciplined because they cooperated with the staff investigators?

Mr. SMITH. No, sir, we are not aware of any employees who were dismissed or otherwise punished on the basis of their cooperation with this subcommittee. We did encounter employees initially who made admissions to us but said they would not repeat them to company management because they were afraid they would be fired for having made those admissions.

In at least one rather dramatic instance, that type of admission came just hours after a meeting we had held with company officials in which they assured us that the company policy was contrary; that no one would be punished for cooperating with us. I conveyed this to the employee. I personally took him down to the officials who made that representation. As far as I know, they made good on it.

Senator PERCY. I am sorry, Mr. Chairman. I didn't know Senator Stennis actually joined the subcommittee. I yield what time I have left.

Senator STENNIS. Thank you very much, Senator. It is good company when I come and sit with you. This concerns me, of course. I am glad to get to hear the testimony direct. Thank you very much.

Chairman ROTH. Senator Stennis, would you care to ask any questions at this time?

Senator STENNIS. I believe not, Mr. Chairman. I thank you. I appreciate it.

Chairman ROTH. Rather than continue, although we don't want to shut off any questions, these two gentlemen can return at a later time if any Senator desires, but time is moving on.

Senator NUNN. May I ask one other question briefly, Mr. Chairman? You mentioned the FBI in their interview accompanied officials there while employees were being interviewed on—was this a criminal investigation by the FBI?

Mr. SMITH. Yes.

Senator NUNN. Is that a normal FBI investigative technique of having employees in the presence of their supervisors when they are interviewing a criminal matter? Do you know whether that is indeed standard operating procedure or was that unusual?

Mr. SMITH. I can't answer that for the Department of Justice or for the Bureau. I can only say there will be a representative of the Justice Department here tomorrow who perhaps can answer that question.

Senator NUNN. Thank you.

Chairman ROTH. Thank you, gentlemen.

At this time, we would like to call forward Mr. Terrence Brunner. Mr. Brunner, would you continue standing, and all those who are joining you? Please raise your right hand.

Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. BRUNNER. I do.

Mr. MANIKAS. I do.

Ms. PETERSEN. I do.

Chairman Roth. Would you please introduce your colleagues and then proceed with your testimony.

Mr. Weiland. Mr. Chairman, while he is preparing, may I ask to submit for the record these brief summaries of the Ingalls' internal audit reports and DCAA audit reports which were prepared by the staff and referred to during the previous testimony.

Chairman Roth. Without objection, so ordered.

[The documents referred to were marked "Exhibit No. 1," for reference, and follow:]

[Exhibit No. 1]

INGALLS INTERNAL AUDIT REPORTS

(We have 17 reports in total. Here is a listing of the most significant ones.)

May 1977.—Arbitrary rotation; recommendation: prohibit allocation or estimating. One manager said he had been estimating "for years"—at audit, had a 58.3 percent mischarge rate.

November 1980.—Supervisors mischarging to "make up time from week before"; "Mischarging a growing trend"; Auditor's Recommendation: tell them not to do it.

May 1, 1981.—Pre-directed mischarging found in another cost center. Auditor's says: "Reclassification would create budget problems."

April 9, 1981 (Audit S-81-31).—"While findings described above would normally result in recommendations for reclassification to change classification at this time would create budget problems."

March 9, 1981 (Audit S-81-27).—"Direct labor is charged to contracts in accordance with a memorandum which designates individuals to charge to certain contracts for the month. This designation is made according to the available budget and not necessarily to storeroom assignment or the functions being performed."

March 25, 1981 (Audit S-81-29).—"Employees charged to contracts without considering the contracts on which they actually worked."

June 30, 1982 (Audit S-82-35).—Included Marine Design (CC 555): found charging according to budget.

DEFENSE CONTRACT AUDIT AGENCY AUDITS

(We have 30 audits in total. Here is a listing of the most significant ones.)

April 1975—No. 1421-99-5-0085.—"The magnitude of the number of rejects being experienced casts doubt in reliability of the contractor's whole timekeeping system."

July 1975—No. 1421-99-T-0105.—"Supervisors do not place the proper significance on accurate timekeeping."

February 24, 1977—No. 1421-7-0043.—24.5 percent of employees checked were mischarged, including arbitrary charging to hulls not actually worked. Such charging to wrong contract has potential annual cost of $573,000 just for employees caught in floorcheck.

March 12, 1980—No. 1421-OC130123.—Cross-charging with potential annual impact of over $3 million.

March 11, 1981—No. 1421-1C130122-4.—7 percent mischarge rate is "insignificant" and not worth discussing with contractor.

April 10, 1981—No. 1421-1C130122-7.—7 percent mischarging rate insignificant, not worth discussing with contractor.

June 11, 1981.—"The examples discussed above are not considered to cover the entire breadth of the condition. Similar conditions are believed to exist throughout the entire ISD. . . ." "2 percent of Engineering's employees classified as indirect. . . . In our opinion, an indirect manning rate of 2 percent is almost inconceivable especially considering that Ingalls currently has over 50 different Navy and Comm. contracts identified in its General Ledger . . . we believe that the cost impacts could be significant . . . the contractor should be requested to submit a cost impact proposal for making the necessary contract price adjustments."

June 24, 1981.—Work mischarged according to pre-planned schedules. Totally unacceptable. Should be stopped immediately.

August 25, 1981.—No. 1421-0C130173.—"When projected over the total direct labor incurred for a year, the error rate of 7.3 percent has a significant impact on validity of labor distribution data used in Ingalls' overall management of contract costs.

September 28, 1981—No. 1421-2C13019-2.—9.6 percent mischarge rate. We recommend that Ingalls be told to take immediate action to improve the accuracy of its timekeeping.

October 13, 1981—No. 1421-1C130122-8.—Pre-planned schedules found—"highly improper timekeeping practice". "Completely destroys credibility" of any cost data generated.

June 15, 1982—No. 1421-2C1300199-7.—16 percent error rate on timekeeping. Government had 8 percent; mischarges to commercial 40 percent—"16 percent combined is one of the highest we have reported in recent floorchecks in any area of the shipyard."

November 11, 1982—No. 1421-2C130119-10.—Pre-planned schedules in CC319—58 percent mischarging rate. Contractor: instructed employees to stop using preplanned schedules.

TESTIMONY OF TERRENCE BRUNNER, BETTER GOVERNMENT ASSOCIATION, ACCOMPANIED BY PETER M. MANIKAS, LEGISLATIVE COUNSEL, CHIEF OF THE WASHINGTON OFFICE; AND SUZANNE PETERSEN, INVESTIGATOR

Mr. BRUNNER. Good morning, Mr. Chairman, First of all, let me thank you for your kind invitation to testify this morning.

Chairman ROTH. Will you pull the microphone forward so you can be heard in the back of the room as well as forward?

Mr. BRUNNER. Yes, sir. As you mentioned, my name is Terry Brunner, executive director of the Better Government Association. With me are Peter Manikas who is legislative counsel and chief of our Washington office, and Suzanne Petersen who is the investigator from our Chicago office who directed this particular investigation.

Let me just mention who we are. The BGA is a 60-year-old citizens' watchdog group in Illinois. We have been running a citizens' investigative program for 20 years. We normally do investigations on a cooperative basis with representatives of the media; radio stations, television stations and newspapers.

Chairman ROTH. Can everyone hear adequately? Would you pull the microphone closer and speak a little louder?

Mr. BRUNNER. I am not sure it is operable, Mr. Chairman. Let me say we are governed by a bipartisan board of trustees and 48 directors who represent every political viewpoint in the Illinois area as well as a national advisory board.

[At this point, Senator Bingaman withdrew from the hearing room.]

Mr. BRUNNER. Our chairman is E. Stanley Ingland who is past president of First Federal Savings & Loan Association of Chicago. Vice Chairman Marjorie Bent who is still, I believe, the U.S. representative of UNICEF, and before that appointed by President Carter to negotiations with Mr. Paul Newman at the United Nation.

Over the past few years, we have completed a number of investigations. The most significant probably was done with "60 Minutes" in which we ran a medicaid clinic in Chicago and filmed people offering kickbacks to us in that clinic and ripping off the medicaid program. The result was testimony before the Senate Committee on Aging before Senator Moss. That particular film is now shown to the FBI as a training film on fraud.

Recently I participated in a conference on fraud, waste and abuse in Government programs at the Department of Justice where, again, they led off with this particular film we put together. Last year we testified in the House on a report on the caucus system which resulted in Representative Hawkins putting together a subcommittee which eventually accepted our recommendations and changed the House rules in the caucus system.

My background, Mr. Chairman: I am a former assistant U.S. attorney. I was a corporate lawyer in Wisconsin. I was district attorney of Marathon County in Wisconsin; special attorney with the organized crime racketeering section in the U.S. Department of Justice and most recently, before I accepted the BGA position, I was the attorney in charge of the organized crime strike force in Pittsburgh, Pa., for Pennsylvania and West Virgina.

Mr. Manikas has a law degree, and a masters degree in political science. Before coming to the BGA, he was the legislative assistant to the U.S. Representative Sidney Yates. Ms. Petersen has an advanced degree in Social Service Administration from the University of Chicago.

First, Mr. Chairman, I would like to thank this particular subcommittee for inviting us to testify today. We believe the problems we are here to address are terribly important. No matter how much we spend on our Nation's defense, these dollars should be spent efficiently. Unfortunately mischarging destroys the credibility of the cost figures and makes it impossible to determine how much security we are buying for our defense dollar.

I have a long statement which we have prepared for submission into the record, Mr. Chairman. What I would like to do is summarize that and tell you, since we already had lengthly testimony by the Senate staff, what our role was in this particular investigation.

Chairman ROTH. Your full statement will be included in the record.[1] I would also offer Senator Nunn's statement to be included as if read.[2]

Mr. BRUNNER. Mr. Chairman, we first became involved in this project about 8 months ago. It grew out of an earlier investigation we did on Public Law 85–804, a law which permits the President or his designees to modify Government contracts when it is determined that doing so would "facilitate the national defense." In practice, that law has been used by the Defense Department to bail out contractors who made expensive mistakes.

Shortly after we began our investigation on the Pascagoula Shipyard, we made preliminary findings that identified serious problems. We contacted CBS's "60 Minutes." We also brought preliminary evidence we had to the staff of this subcommittee who then launched their own independent investigation.

In the course of our investigation, BGA staff interviewed over 80 persons throughout the country. We reviewed thousands of pages of documents. We relied extensively on the Freedom of Information Act and obtained much of our material by using that law. The cumulative results of these efforts are, of course, the CBS "60 Minutes" piece broadcast on April 24 called Dollars Away and these hearings today.

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[1] See p. 169 for the prepared statement of J. Terrence Brunner, Peter M. Manikas, and Suzanne Petersen.

[2] See p. 167 for the prepared statement of Senator Nunn.

[At this point, Senator Percy withdrew from the hearing room.]

Mr. **Brunner**. I certainly hope our efforts result in tangible reform which will save taxpayers dollars and prevent further abuses from occurring.

I would like to point out one aspect of the methodology used, Mr. Chairman. That is, unlike the Senate committee, we received no cooperation from Ingalls Shipyard and very little, if any, cooperation from the U.S. Navy. Our investigation was completely put together by interviewing people on the fringes, the employees of the shipyard, people that worked there who were willing to talk to us with the promise of confidentiality, by filing numerous freedom of information requests which were fought tooth and nail by the Navy.

In one instance, Ingalls filed an action to keep one of the DCAA audits, which you were talking about earlier in your mention of 13 DCAA audits, from being received by us. We asked to talk to Ingall's representatives at a particular point in time after receiving a letter from them suggesting that they would make every audit available to us. We were working on a joint basis with "60 Minutes" at the time. In fact, we were unable to talk to the middle level managers who were accused by the employees we talked to to find out whether or not there was complicity in the scheme.

There has been a lot of discussion already, Mr. Chairman, with regard to mischarging. I think that is probably the most serious problem we uncovered, the practice of billing the Navy for work done on other projects. The Senate staff has already elaborated on their findings and many of their findings are similar to our own. Unfortunately, as I mentioned before, we didn't know until this morning what the results of that investigation really were, plus we did not have access to either discussing any of this, looked at any Ingalls' documents or, in most instances, we had nothing from the Navy except those freedom of information requests that dragged it out from the Navy.

Our findings are set forth in detail in our written statement. Briefly, however, there were three major problems we found. That is, mischarging at Ingalls Shipyard had been both deliberate and planned. Supervisors of the shipyard instructed employees to deceive defense auditors by keeping phony documents and by lying to the auditors about what they were working on and, in some instances, they were even told to destroy documents. Ingalls' workers were sometimes warned in advance when the auditors were scheduled to visit. Our investigation showed three separate distinct types of mischarges.

The first was the guided missile destroyers 993 and 997. Work done on private oil platforms were charged to these ships. The mischarging that took place was a subject of a civil false claims action recently settled for over $137,000. We found that the mischarging that took place was planned in advance, with full knowledge that it was being done. In fact, one section manager we talked to said he personally refused to participate in the scheme because he thought it was fraud.

[At this point, Senator Percy entered the hearing room.]

Mr. **Brunner**. The second instance we found was a $1 billion cruiser. There, an engineer's time was charged to a cruiser. He told us he was instructed by his supervisor to keep two sets of records. He said when auditors for DCAA arrived, he would show him the Navy contract when, in fact, he was working on the private oil rig. Ingalls' employees were given advance notice by the supervisors as to when the auditors were coming. One Ingall's planner told us although he worked on overhauling the *Tenosa* nuclear submarine, his timecards were filled out for three other submarine overhauls.

BGA was told mischarging was done to obscure poor performance which might jeopardize future Government contracts. When he refused to sign false timecards and complained to superiors, the planner was promptly fired.

The point I would like to make about mischarging, not only is it illegal, it also completely destroys the credibility of the figures the Navy uses. If the bills submitted to the Navy don't reflect the work that was really done, you can't know how much security our defense dollars are really buying. We don't know how much money the Navy lost. Government audits uncovered mischarging for labor up to 50 percent in particular sections.

If the labor mischarging amounted to only 1 percent of Ingalls' Navy contracts, the loss to the Government is close to $60 million over the last 10 years.

A second area we looked at is that of habitability improvements. We uncovered waste and extravagance on the part of the Navy. We found some of our newest warships being equipped with high-priced, custom-made furniture, furniture that seems more appropriate for the television show "Love Boat." Standard furnishings were ripped out and replaced to satisfy the interior decorating demands of high-ranking naval officers.

One naval employee told us there is a lot of competition between the ship commanders to grab all the gusto they can get, particularly when there is money left at the end of a shipbuilding contract.

The wardroom of the U.S.S. *Callaghan* was equipped with a $14,000 custom-made leather sofa; $13,500 custom-made combination bookcase television storage cabinet and planter, including plants and grow lights, elephant sculpture lamp with silk flowers costing $250.

On the *Fletcher*, we saw several thousand dollars of color-coordinated reupholstery on that particular ship which included the purchase of a $200 custom quilted bedspread.

Ms. **Petersen**. This is the bedspread fabric.

Mr. **Brunner**. For the captain's bed, a pear-colored bedspread. These oriental draperies were $650 along with this fabric which was purchased for chairs. All of this was to match the paprika velour carpeting which cost $2,186.

Likewise, on the U.S.S. *Kidd*, the captain's wardroom was outfitted with a custom-made leather sectional sofa and a custom-made Chippendale-type sofa made out of mahogany on a destroyer, Mr. Chairman, handmade for $18,000. Also, wool carpeting was installed which cost $41,000. The Navy suggested they needed it for durability. This is in contrast to the other destroyers where the carpeting only cost $40 per yard.

In this particular instance, Litton continued to tack on various administrative costs, profits, a trip to New Orleans to interior decorators to look for carpet which brought the total cost of carpeting up to $94 a yard.

As you know, we are in Chicago. One of our investigators picked up the telephone, called Sears & Roebuck and asked, "What is the most expensive carpeting you have got?" He said, "$30 a yard." "How about all-wool, pure-wool carpeting, how much would that be? They said, "We don't carry anything like that." They said, "That is out of date. We have synthetic carpets. If we carried all wool, it would be so expensive that no one in America would ever buy it." That is what the Navy did in that particular instance. Shipyard employees who toured the *Kidd* told us there were a number of people who said the same thing. They couldn't decide whether this ship looked more like a funeral home or a house of ill repute.

Let me suggest to you again, we were also told over and over by people who said: "Mr. Brunner, you have to remember, these are supposed to be warships."

One thing I would like to mention at this time is the cooperation of the people in the State of Mississippi. These folks came to us, as I mentioned. We conducted between 80 and 100 interviews with people who worked in the local shipyard. Consistently they said the same thing to us:

> Mr. Brunner, we have to get our top defense dollar. We have to make sure this country is prepared if we have to fight another war. We have got to make sure our weapons are good. We are not getting the best weapons because we are doing a lot of crazy things. People are treating this money as if it is funny money, Government money, and it is somehow different than it is when we work on commercial projects. It has got to be stopped.

We were amazed with the patriotic nature of the people who came forward to us down there and talked to us.

Two points have to be emphasized. First, there were no effective limits on what specific items the captain could order. He could order anything. These items they purchased were the result of unbridled caprice. Second, there was no competitive bidding. Consequently, once the items were selected, there was no selective control whatsoever on the cost of the items. Regardless of how someone feels about the level of defense spending, I think no one wants the taxpayers' dollars spent whimsically.

The third area we looked at is what is called BOA's. Senator Percy already mentioned one example. This was an area of waste which we uncovered which involves the use of these agreements which are between the Navy and the Navy contractors, supposedly to speed up the delivery of certain items to the Navy because it is believed to be more efficient and convenient. What we looked at was neither efficient nor convenient. In fact, purchases were made buying items at a highly inflated cost. We found the material ordered by Ingalls could have been obtained as quickly by the Navy itself at a fraction of the cost.

Sometimes the Navy used the agreement to procure items it didn't urgently need. Under this agreement, for instance, Ingalls sold this gravity timer switch, which Senator Percy showed you, to the Navy as part of an assembly.

Senator PERCY. It regulates the flow of water in the toilet.

Ms. PETERSEN. That is what I understand.

Senator PERCY. What are the prices the Navy paid Ingalls for it, and what were you able to buy it for, an exact, identical part from the manufacturer, the same manufacturer that sold it to Ingalls?

Ms. **Petersen**. The Navy paid $256 for the switch. Ingalls bought this switch or replacements for that particular switch directly from the manufacturer for $11. The BGA was able to purchase it—the switches you have—for $12 per switch.

Senator **Percy**. What is a possible explanation for paying over 2,000 percent more than you could buy it for? Was it needed urgently? Did they have to buy it as a first-class seat across the country in a Concorde or something like that to get it there? How could they justify that?

Ms. **Petersen**. The purpose of the process, the basic ordering process, is to expedite procurement for urgently needed items. The problem with the order for this switch is the Navy didn't need the item urgently; they didn't request delivery of the item for 5 months. It was delivered promptly by Ingalls but the Navy didn't deliver it to the ship for 5 months after it was ordered.

The switches we ordered directly from the manufacturer we received in approximately 1 month and only paid $12 for it.

Senator **Percy**. Did you buy just one or did you buy more at the $12 price?

Mr. **Brunner**. We bought them in volume.

Ms. **Petersen**. We bought eight.

Senator **Percy**. Certainly Ingalls must have bought even more. They should have gotten a bigger discount. At least paid no more than $12.

Chairman **Roth**. Would you please proceed.

Mr. **Brunner**. Yes, I will. There has been a suggestion, however, that this particular example was an extreme example. The Navy was quoted in yesterday's Chicago Sun Times as saying this is not an unusual example. Maybe, Ms. Petersen, you can mention—we looked at I believe 70——

Ms. **Petersen**. We found there are problems with the basic ordering agreement that have been known by various Government agencies. In 1979, two contract administrators from Supervisor of Shipbuilding Conversion and Repair in Pascagoula wrote a beneficial suggestion to the Navy criticizing the use of the BOA. The example they gave was for a part called the transducer. It was ordered under the basic ordering agreement in July 1979. It wasn't requested to be delivered until October 1979. Ingalls didn't have the part in stock. They ordered it directly from the manufacturer, and Ingalls paid $420 for the transducer, but they charged the Navy $634 and didn't deliver the part until November 1979.

Again, in 1982, the Naval Audit Service criticized the use of this same basic ordering agreement. They cited one outrageous example where Ingalls was paid $21,000 for simply making a phone call to a manufacturer to get the part for the Navy. The problem is the basic ordering agreement is being abused. They are ordering parts that are not urgently needed or Ingalls is acting as a middleman between the manufacturer and the Navy and charging the Navy inflated costs for the administration of the process.

Mr. **Brunner**. Mr. Chairman, another area we looked at was suggested in a speech by one official of the Ingalls Shipbuilders that we were big city investigators who came down to Mississippi to spend our time poking around a junkyard. There is some truth to that. We spent a lot of time, because we heard allegations from a number of people and, incidentally, it is not very hard when you go down there to get people to talk to you and tell you the same thing over and over again, that outside the shipyard in Gautier, Miss., it was possible to buy brand new Navy parts. One allegation was you could buy a giant part from the junkyard which was a window, if you want to call it that, for the bridge of a destroyer. Our problem was we had to carry these things on airplanes.

Suzanne Petersen went out to the junkyard. The first thing we bought was a valve still in its packing crate. It is used to control the flow of fuel on Navy ships. We paid $70 for it. According to Navy officials, the current price is $636. The second thing we purchased was called a differential pressure indicator which is a long phrase for what is called a gage. It is used to measure pressure. We paid $8 for it. The manufacturers said the current price of this gage was $500.

You will notice on that gage the green tag is still on there. The manufacturer told us it is safe to infer from that tag that that gage is brandnew and will still work as well as it ever would have, and it, in fact, had never been used. The owner of the scrapyard told us his yard is full of material used in shipbuilding. He buys scrap and surplus in a bidding process. Although he cannot explain why the valve and gage would end up in his landfill, he speculated it was thrown in the trash. The problem is so bad that he sent his customer relations personnel out to buy back from scrap dealers, parts that had been previously sold to the military. This is the fellow with the gage. Maybe you ought to relate that conversation.

Ms. **Petersen**. This gage is manufactured by ITT Barton in California. I called the manufacturer to find out what the gage was used for, and the history of it. I was reading the numbers off on the back, contract numbers and various descriptors that indicate what the part is. He interrupted me. He was in the process of telling me that this gage is worth $550 today, but he stopped and said, "Oh, no, I think I know what you are getting at. You have got a case where somebody paid $550 for that, but someone else bought it for $10." I said, "You are absolutely right. How do you know about this?" "Well, it's a common practice in California. We used to send our customer-relations people out to buy the parts back." I then spoke to one of the gentlemen at ITT Barton who had worked in the customer-relations department and had gone out to purchase materials back from scrap dealers, and he said he had seen numerous items that were unused that were still in their special packaging that the manufacturer had put the items in to ship to the Government.

Senator **Percy**. Mr. Chairman, could I just ask one question at that point of Ms. Petersen? Did you just stumble across these things in a junkyard?

Ms. **Petersen**. We went out and visited the sanitary landfill in Gautier, Miss. The landfill is full of shipbuilding parts and equipment, some of which the owner of the yard does buy through a legitimate scrap surplus bidding process. We had been told if we walked around and looked through the yard that we would find materials that appeared not to have been used. They still had tags and descriptons on them. Some would say they are still valuable.

We went into the yard with local people who could recognize the parts and help us pick them out.

Senator **Percy**. Would it be possible for other manufacturers to go to the junkyards like the one in Gautier, Miss., and actually find spare parts like the fuel valve and resell the parts for a hefty profit?

Ms. **Petersen**. ITT Barton in California said they had repurchased some of their equipment, but they have a policy against selling it back as new. What they do is break the pieces down to their component parts and use those over.

Senator **Percy**. Mr. Chairman, I would like to ask unanimous consent to insert a letter I have just received and a telegram from the Department of the Navy into the record indicating the positive action the Navy intends to take to remedy some of the situations that have already been revealed. Both Secretary Lehman and Admiral Watkins have taken a personal interest in the issue. A high-ranking naval officer assured us, "this type of situation will not be repeated." I am encouraged by the level of concern and action on the part of the Navy and ask that it be inserted in the record.

Chairman **Roth**. Without objection, it will be incorporated.

[The correspondence and telegram referred to by Senator Percy follows:]

U.S. Senate,
Washington, D.C., April 29, 1983.

Rear Adm. Byron B. Newell, Jr.,
Chief of Legislative Affairs,
Department of the Navy,
Washington, D.C.

Dear Admiral Newell: Recently, much attention has been focused on the Navy's use of funds for habitability. It appears that, at least in certain cases, the Navy has gone beyond what is reasonable in making ships more livable for our men at sea.

Having served in the Navy for many years, I am well aware of the need to be sure our ships are well-equipped and comfortable and that adequate recreation and entertainment are available. However, certain expenditures made for items for the U.S.S. *Kidd*, the U.S.S. *Callaghan*, and the U.S.S. *Chandler* appear to exceed what is reasonable.

For example, my staff has received copies of invoices for the following purchases: A $14,000 sectional sofa; a $13,500 bookcase; $2,450 for two love seats; a $1,705 coffee table; a $1,500 portrait; and a $930 brass telephone stand.

Because I know that the Navy is as concerned about this issue as I am, I think it is important that we have public answers for the following questions:

Are these invoices correct? If so, are we dealing with isolated instances, or is this common practice?

What, if any, corrective action has been taken?

Can we be confident that this type of situation will not occur in the future?

As you know, this issue will be discussed in a Permanent Subcommittee on Investigations hearing on May 3. I would appreciate hearing from you before the hearing so that we could give the Navy public credit for any actions you are taking to make sure this situation does not happen again.

Thank you for your attention to this matter.

Sincerely,

Charles H. Percy,
U.S. Senator.

THE CHIEF OF LEGISLATIVE AFFAIRS,
Washington, May 2, 1983.

Hon. CHARLES H. PERCY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PERCY: In response to your letter of 29 April 1983 regarding the Navy's use of funds for habitability, I can assure you that the Chief of Naval Operations and Secretary of the Navy have taken personal interest in habitability expenditures associated with new constructions and modernization of the Fleet.

The invoices you cite in your letter are correct. Expenditures of the amount reflected in these invoices are certainly not common practice in outfitting U.S. Navy ships. While there were some unusual circumstances associated with these four ships, which were originally contracted for by the Iranian government, the habitability expenditures reflected are excessive.

As you know, for several months various allegations of fraud, waste, and abuse have surfaced regarding shipbuilding at Ingalls. Each allegation has been thoroughly investigated. In one case, restitution to the Navy has been made by the shipbuilder. When these allegations were first made, action was taken to insure that the regulations regarding construction and outfitting were clearly understood. The specific area of habitability was the subject of a personal message from the Deputy Chief of Naval Operations for Surface Warfare to Surface Ship Type Commanders calling for the continued exercise of "fiscally prudent and judgmentally sound" methods.

In addition, the Chief of Naval Operations has directed the Navy Inspector General, Rear Admiral Henry Mustin, to conduct a specific review of the habitability outfitting of the four KIDD-Class guided missile destroyers. Rear Admiral Mustin is in the process of conducting that review now.

Based on the clearly evident resolve of Admiral Watkins and Secretary Lehman, you can be confident that this type of situation will not be repeated.

Sincerely,

BRUCE NEWELL,
Rear Admiral, U.S. Navy.

[Relay Level Message]

R 241528Z Jan 83.
Fm CNO Washington DC.
To RUWTAA/COMNAVSURFPAC San Diego Ca.
RUCESAA/COMNAVSURFLANT Norfolk Va.
Unclas personal for Vadms Briggs and Schrader from Walters.
Subj: Surface Ship Habitability.

A. OPNAVINST 9640.1.

1. The current media interest in shipboard habitability expenditures in selected ships highlights. I believe, isolated instances where good judgment has not prevailed by some in outfitting/improving this important area of shipboard life. I have reviewed Ref A and believe it is a clear statement of Navy policy concerning the standards toward which we are working.

2. I ask that you review Ref A and stress within your organizations the absolute necessity for complying with both the spirit and letter of current directives. I believe it is essential to continue to support habitability improvements both in our new ship designs as well as those already in the fleet. We must do it, however, in a way that is fiscally prudent and judgmentally sound.

3. I would welcome your comments in this area. Fundamentally, however, we must insure that dollars allocated to this area are obligated wisely toward their intended purpose, which is to preserve and support mission effectiveness through people. Warm regards.

Chairman ROTH. I would like to ask you, Mr. Brunner, to try to summarize, if you could.

Mr. BRUNNER. Yes, sir, Mr. Chairman. This concludes the presentation based on our written testimony. We only have a couple of things we would like to mention with regard to oversight, particularly regarding the sorts of questions Senator Nunn was asking before. We looked at the situation down there. First of all, with regard to DCAA auditors, I am sure most of them are hardworking and want to do a good job. They simply have not obtained the skills to detect white-collar fraud. You are asking people to do this job and they are not qualified to do that.

We had lengthy discussions with people in the Defense Department about the problems. The statistical referral rate is absolutely terrible. There are like 60,000——

Mr. MANIKAS. 32 cases of 60,000——

Senator NUNN. I didn't hear that.

Mr. MANIKAS. In 1982, the referral rate to investigative agencies was 0.08 percent, which is contrasted with GSA's referral rate of 3.3 percent, 42 times as great as DCAA's. DCAA referred 32 cases out of 60,000 pre- and post-award audits.

Mr. BRUNNER. It is very bad. Likewise, the statistics are terrible on the amount of money involved. Most of the caseload is below the $500 level which, of course, is not unusual for these sorts of investigators. I think the problem is similar to that found in Justice with regard to the Internal Revenue Service with the difference between special agents and revenue agents. We must teach revenue agents to pick up a criminal violation when looking at money cases. This is not being done by DCAA people. I don't think it is malicious on their part that they do not aggressively monitor contractors' performance. Their attitude appears to be more that "the contractors are our clients." From this point of view, it seems much more important to get ships built on time than to insure the tax dollars are spent efficiently and wisely.

Several of those steps are discussed in our testimony and it should be noted that the Navy does not have to wait for indictment or conviction before it acts. During the time we are talking about, much of that time Ingalls Shipbuilding was under criminal indictment by the U.S. Department of Justice, yet there were no administrative remedies ever taken in that situation, and the Justice Department said nobody ever considered it.

I think if you take a look at how these are put together, you will see they are really tough.

[At this point, Senator Percy withdrew from the hearing room.]

Mr. BRUNNER. A new unit was established last October and this unit told us mischarging cases will be one of their top priorities. The unit is, of course, new and has not established a track record. The case recently dismissed by the Federal district court in Mississippi for lack of prosecution is a real matter of concern. Second, the fact they were willing to settle that case for $137,000, which Mr. Smith mentioned, with no discovery, no deps, no interrogatories, no documents, they relied upon cooperation from Ingalls to reach that conclusion, that is not what I call a hard-headed, tough-minded prosecutorial approach to these kinds of problems.

[At this point, Senator Nunn withdrew from the hearing room.]

Chairman ROTH. Thank you, Mr. Brunner. Again, I would like you to summarize briefly the nature of your organization and how it is financed.

Mr. BRUNNER. We have approximately 3,500 members in our organization from across the country. They join by direct mail. We don't know who they are. They send us $35 a year to be members of the BGA. We have many, many contributions from the business and industrial community in the Chicago area. I would think of the largest business enterprises in Chicago, probably 90-plus percent are contributors and members of the BGA and our board of directors reflects that.

We also have large foundation grants from a number of foundations across the country.

Chairman ROTH. It is my understanding you began this investigation of habitability and called it to the attention of the Permanent Subcommittee on Investigations; is that correct?

Mr. BRUNNER. That's correct, Mr. Chairman.

Chairman ROTH. I think in fairness to you, since you are on first, I would note that at a later time in the prepared testimony of Mr. Erb, that the comment is made:

> Do we punish those for going to those who deal in sensationalism for commercial gain and entertainment, or those who are self-appointed pseudo-investigative bodies that are neither legitimate media or government and who are answerable to no one for their conduct?

He says in answer to the question:

> Do we punish employees for going to legitimate government agencies with information about our company? The answer is no—and we never have. Do we punish them for going to those who deal in sensationalism for commercial gain and entertainment, or those who are self-appointed pseudo-investigative bodies that are neither legitimate media or government and who are answerable to no one for their conduct? The answer to that is no—but we don't encourage that kind of conduct.

Would you care to comment?

Mr. BRUNNER. I assume the reference would be to CBS News and the program 60 Minutes, No. 1. I really can't defend Mr. Wallace or the program. We worked with them, and I would think they have a history of being responsible journalists.

With regard to point No. 2, all I can say to that, Mr. Chairman, is that we have no more authority or any less authority than the average citizen to monitor Government. We are a taxpayers' watchdog group, much the same as the Sierra Club and the League of Women Voters.

I guess our response to the fact we are self-appointed is we have two groups of monitoring people made up of Democrats, Republicans, industry people, housewives and an across-the-board spectrum of people in the Chicago area. I would point to a lot of the reforms entered into by the Congress in response to the investigations which we have presented in past hearings such as these. In fact, Mr. Chairman, I think you are well aware, we presented our evidence to you on the ripoff in the medicare program and home health program and many of the recommendations we put together with the Center for Welfare Policy at the University of Chicago were adopted by this subcommittee as part of your report.

Chairman ROTH. I personally think your organization has done a service in initiating a number of these actions. It has been our policy that subsequently the Permanent Subcommittee on Investigations should then make its own independent investigation to determine what the facts are. But it is the practice of this subcommittee that we welcome information from anyone, not only from any organization but from any individual that might show that Government funds are not being properly spent, but I do want to publicly give you credit for initiating the action on the habitability.

Frankly, one of my concerns there, and I was happy to see the letter of Senator Percy where the Navy is at the highest level apparently taking remedial action. I question whether that would have happened if it had not been investigated and disclosed both by your organization and our own.

I am more critical of the Navy. I think there is a good argument in favor of habitability if money is properly spent to be sure the life on board a vessel or submarine, as the case may be, is made as decent as possible under very arduous, trying circumstances.

[At this point, Senator Nunn entered the hearing room.]

Chairman **Roth**. The problem is that too often these kind of situations result in misuse and abuse.

I might say I will be interested in the second problem raised by you and what both the auditors of the Department of Defense and administrative officials have to say with respect to basic ordering agreements.

Do you have any evidence that any auditors or any Government officials have been questioning these and trying to correct the situation? Would you care to comment?

Mr. **Brunner**. Ms. Petersen mentioned a young lady by the name of Collins who was the contract auditor on the switch we were talking about. In that particular instance, Ingalls suggested the Navy ought to pay something in excess of $500 for that switch. They then met and argued what the price should be, and she knocked it down to $256. After that, she and another contract auditor down there, who Suzanne Petersen mentioned, put into the record beneficial suggestions to the effect that this is just not a good idea, that you shouldn't continue to do this because it is based upon the idea that the part is going to be there and you have to have it right now.

What is happening, of course, is that the contractor, as you suggest, is willing to indulge the Navy. The contractor is in business to make money. If the Navy wants to buy carpeting for $97 a yard, they are willing to sell it to them. The same thing is true with switches at these prices. I don't know that you can blame the contractor in this particular instance for this conduct. We have suggested that. The people clearly at fault here are the Navy. The stated reason they were doing it is for some tremendous national defense need.

One of the very simple suggestions made in the Department of Defense regs with regard to this is that they are supposed to be doing something every person in business in the United States of America does every day, it is called "get a quote." The suggestion is made they are supposed to pick up the telephone, call a couple of people, see what it costs and buy it from them. Specifically that is suggested for things that are over $500 in the regs. But what happens is they do this for convenience. They don't want to go to that trouble so they go through this circuitous process in which Ingalls charges them additional load factors for their effort which gives you this result which is way out of whack.

Chairman ROTH. My final question, based on your investigations and research, do you believe similar procurement problems exist at other shipyards or other facilities?

Mr. BRUNNER. As I mentioned to you, Senator, the methodology of our investigation is basically talking to people that did the work. We talked to guys that put parts into ships, people that were engineers on the blueprints. They consistently told us that the sort of thing that goes on in Pascagoula, Miss., and Ingalls is present through the industry in other shipyards.

All I can tell you is what they said. That is the word on the street. I submit that for nothing more than that is where it is coming from. We don't have the resources to look at other shipyards. We hope when we do these things that we bring it to the attention of a subcommittee like this, that you are going to do the investigation, the Justice Department is going to get a little more desire, that the public is going to become aware that you who are always so concerned are going to take these things seriously, and we are going to make sure the taxpayers' dollar is spent more efficiently.

We can't go out and look at other shipyards. I can tell you consistently the folks who work at the lowest levels of that shipyard at Pascagoula believe other people are doing the same sort of things in other shipyards. In fact, many of them worked at other shipyards; they came down with one subcontractor, then got on at Ingalls, they have a record of working through these various places, and that is what they say.

Chairman ROTH. Senator Cochran.

Senator COCHRAN. Thank you, Mr. Chairman. First, let me commend you and your colleagues for your commitment to trying to do something about uncovering instances of misuse of tax dollars, inefficient use of tax dollars and Government money, waste, and fraud. I think, according to the chairman and those who worked closely with you here on the Hill, there have been several instances in which you have made a very valuable contribution to the work of the Congress and this entire effort that is so important to all of us.

I know, too, you were up against a difficult problem compared with the staff of this subcommittee in obtaining all of the documents or information that you might have wanted to have in order to make some conclusions, and you submitted a written statement which I have read indicating some conclusions that you have drawn from the information that you did obtain.

My purpose in asking a few questions of you is to simply clarify for purposes of the record what the facts may really be in some of these instances in which you have drawn some conclusions that look to me to be inconsistent with the factual basis on which they may be supported. I don't say this to accuse you of any kind of intentional effort to mislead anybody. But since that is a part of the record, and we are supposed to be making decisions here and drawing conclusions based on facts and you are a witness here to provide this subcommittee with factual information, I think it is important to make sure that you are suggesting the facts to be are supported by the evidence.

In that connection, you refer in your statement on page 3 to a conclusion based upon a DCAA audit. I am assuming when you suggest that there is evidence of 58 percent based on a sample in an audit of mischarging hours by Ingalls of work to the Government for work that was actually done on oil rigs that you are basing that upon some audit. Is the audit in question one that you uncovered with a request under the Freedom of Information Act to the DCAA?

Mr. BRUNNER. Yes, sir.

Senator COCHRAN. Is that audit one that was conducted in June of 1982?

Mr. BRUNNER. Yes.

Senator COCHRAN. In order we be fully advised of the specific audit, I am assuming you are basing the conclusion on—one is dated November 11, 1982, but it refers to a floor check that was performed during June of 1982. This audit then, if I may be permitted, Mr. Chairman, refers to a review of timekeeping and attendance practices involving 62 Ingalls employees; is that correct? Are we talking about the same audit?

Mr. MANIKAS. Forty-three.

Senator COCHRAN. There are three different listings of kinds of employees. The first group numbers 43; the second, 12; the third, 17. We are talking about the same audit then, and that is the audit on which you base the conclusion that as much as 58 percent of the time of this one shop was being charged to the Government for time actually worked on oil rigs; that is what your statement says, does it not?

Mr. MANIKAS. That's correct.

Senator COCHRAN. Do you also have a copy of a memorandum dated March 14, 1983, which was submitted for the stated purpose of helping to assure that the contents of this audit are neither misunderstood, misused, or concluded as representative in anyway of the contractor's overall timekeeping system? Do you have a copy of that memorandum?

Mr. BRUNNER. Yes, we do.

Senator COCHRAN. And you had that memorandum at the time you prepared your written statement and submitted it to the subcommittee, did you not?

Mr. BRUNNER. I believe we refer to it in our statement, Senator.

Senator COCHRAN. You do?

Mr. BRUNNER. Yes.

Senator COCHRAN. So you had a copy of it at the time you prepared your statement. I want you to read with me, if you would, paragraph numbered 1 on the first page of that memorandum where it says:

> The timekeeping errors observed in this review are atypical in that they are the only instances of labor mischarging between government and commercial contracts disclosed in our floor checks over the past two and one-half years.

Is that information that was available to you at the time you prepared your written statement?

Mr. MANIKAS. Yes, it was.

Senator COCHRAN. My question to you is, isn't it somewhat exaggerated to say, as you did, in your prepared statement in reference to that audit, and I quote from your statement:

> Various audit reports, for example, have found that up to 58 percent of Ingalls' labor charges were incorrectly billed to the Government when small samples were involved.

Do you still consider that to be an accurate statement?

Mr. BRUNNER. Yes, sir, Senator; I think if you take a look at page 6 of our written testimony, the first paragraph, let me read it to you:

> March 6, 1983, 10 months after the first audit was conducted, BGA and CBS' 60-Minutes made a formal request to DCAA asking if a followup audit had been conducted. DCAA responded that although no followup audit was needed, they had reexamined the issue, but now the auditors seem to have retreated from their original findings. DCAA stated the reexamination took place to prevent the original report from being misunderstood, misused or construed as representive in anyway of the contractor's overall timekeeping.

We suggest, in our written testimony:

> Coming to Ingalls' defense, DCAA now says, one, they discovered no other evidence of mischarging in previous audits or floor checks over the past two years; two, not all of the mischarging found in this instance was to the government, that is government work was also mischarged to private contracts; and third, no cost adjustment could be made because they are difficult if not impossible to make and must be justified by extraordinary circumstances.

[At that point, Senator Nunn withdrew from the hearing room.]

Mr. BRUNNER. What we are suggesting there, when DCAA has a bad audit on file and didn't do the proper followup procedures and 60-Minutes and the Better Government Association make a Freedom of Information request to the U.S. Navy, instead of giving it to us right away, they fight us tooth and nail, the contractor files a lawsuit to restrain us from getting that particular audit and when we do finally get it, they go back and rewrite history and write a new, what I would suggest in the file, is a take-out memorandum by DCAA by saying, "Gee, we didn't mean to be so tough in that prior audit."

I thought that was evidence, not necessarily that this showed this was not a representative sample. It is evidence, based on the actions of DCAA people, that they are a little too close to the contractor and they were very interested in covering their rear end in this particular matter when 60-Minutes requested that particular audit.

Senator COCHRAN. Do you have any basis on which to disbelieve the truth of the memorandum dated March 14, 1983?

Mr. MANIKAS. No.

Senator COCHRAN. As a matter of fact, that memorandum purports to explain how the time charges were being made improperly; that is, trying to identify the number of persons whose time was being charged improperly or incorrectly and to which contracts the time was in fact being charged.

The first audit didn't suggest all of those employees who were found to have their time discharged were being charged to commercial contracts, did it?

Mr. BRUNNER. No.

Senator COCHRAN. As a matter of fact, with the total amount of information now available to you and prior to the preparation of your statement, the fact is that only three of the employees whose time was found to be mischarged were doing work that involved drill rigs; do you understand that to be the truth?

Mr. BRUNNER. We understand now, Senator, that there are 13, according to the testimony from the staff, there are now 13 audits. We have requested every one of those from the U.S. Navy, and they fought us on every one. The question, of course, is why is the Navy resisting giving the public audits that indicate a problem in this particular defense——

Senator **Cochran**. We will ask them that tomorrow. My question is to you and whether or not you would like to modify or withdraw a statement that is named in your statement that is submitted to the subcommittee?

Mr. **Brunner**. This is not the only evidence on this particular point.

Senator **Cochran**. That is why I asked you to begin with whether or not this statement is based on this audit. It is the only audit I can find wherein there is any reference to a 58 percent of a review group being found to have their time mischarged, and I presume that is what you were concluding is 58 percent of the time—I am not an audit expert either, and I could certainly draw the conclusion when you are using as a framework to conduct or review time-charging practices the settling of a lawsuit that did involve alleged charging of time to the Government for work actually done on a commercial contract, but my suggestion here is simply for the purpose of trying to clarify the record, to make sure we don't have in the record here a statement that is considered to be fact that Ingalls Shipyard in this one audit was found to have been charging 58 percent of the time of those employees to the Government when the people were working on drill rigs.

Mr. **Manikas**. You are quite right, Senator, the 58 percent was a 58-percent rate of mischarging, not all went to the Government.

Senator **Cochran**. I didn't understand the last part.

Mr. **Manikas**. Not all went to the Government.

Senator **Cochran**. As a matter of fact, there were three employees identified in that March 14 memorandum. It says only three of the reported contract-level errors involved mischarges between Government and commercial contracts. The remainder of the errors represented mischarges between Government contracts of the same type. Then the third paragraph says:

> Two of the three errors discussed involved employees actually working on government cost-type contracts but charging their time to firm-fixed price commercial contracts.

In other words, of the three employees who were found to have been involved in mischarging between commercial contracts and Government contracts, two of them were actually working for the Navy and having their time charged to the drill rigs and only one working on a drill rig and having that time charged to the Navy.

So your conclusion that 58 percent, based on this audit, of the workers in that shop were having their time charged to the Government for work done on drill rigs is just not true. That is what I am suggesting, and it is not your fault it is not true. You may be like me and have had a hard time understanding what these audits really mean until you have all of the information available to you.

Mr. **Brunner**. Senator, let me suggest on page 5 we say:

> In June of 1982, a DCAA audit confirmed that mischarging occurred and found a 58 percent error rate resulting from a "preplanned charging schedule."

The evidence that we looked at—we talked with a gentleman. He had in his hand and gave us the preplanned charging schedule. He said, and you saw him on the "60 Minutes" show, this fellow worked here, he worked here, he worked here. We had all that evidence. Now the evidence we see this morning by the subcommittee staff says that those preplanned time charging sheets were followed by the contractor exactly. There was no difference. We had four different people tell us about that particular scheme, how high up it went in management and these people set this thing up in advance, they put the time charging things and said this is how you are going to charge your time months in advance.

When the DCAA auditors came by and stumbled across it, they said you have got to get rid of those sheets; you can't put that up on the wall like that. This was not told us just by Mr. May who was on the television show, we have affidavits from Mr. Primeaux, we talked to his supervisor, we talked to other people all who confirmed the scheme.

The DCAA audit, when it suggests the 58-percent figure, merely confirmed to us the existence of the scheme. That is not why we used not only that but as I mentioned to you the take-out statement.

Senator COCHRAN. You referred to it, I understand that, and I think it is helpful to the subcommittee in identifying the source of the conclusion that you reach that Ingalls was charging 58 percent of work done by employees on drill rigs to Navy contracts. That is the point where I would like to have clarification.

Mr. MANIKAS. We don't say drill rigs.

Senator COCHRAN. I think the subcommittee's view is a modification of your statement.

Mr. BRUNNER. If you look at our statement on page 5——

Senator COCHRAN. I am reading from page 3. Which are we going to believe, are we going to disregard part and accept the other as gospel? I think it all ought to be accurate, don't you? You are submitting a statement to this subcommittee under oath and you are supposed to be submitting the truth to the subcommittee. I think this is an inadverant mistake of fact.

Ms. PETERSEN. Senator, excuse me. May I clarify? The statement says that we found up to 58 percent of Ingalls' labor charges were incorrectly billed to the Government when small samples were involved.

Senator COCHRAN. Is that true or not?

Ms. PETERSEN. We did find that up to that amount.

Senator COCHRAN. How far up to it?

Ms. PETERSEN. In the *Sita* case we know 62 percent of a certain division's time was incorrectly charged to the Government.

Senator COCHRAN. It would have been 100 percent if the group were limited to the nine engineers involved in the *Sita* case. There were nine engineers; isn't that correct? How many engineers work at Ingalls? A thousand? Is nine 62 percent of 1,000? My point is this. I think in the zeal and effort to dramatize the mischarging practice, which admittedly there was some mischarging going on at this yard, I think that is obvious to everybody in this room and nobody is suggesting that is not correct, but what I am suggesting is this subcommittee ought to demand accurate information from witnesses who are here to present facts.

You are here to present facts and we have a statement here that suggests the company has intentionally charged to Government contracts 58 percent of the work done on oil rigs or commercial contracts in an effort to rip off the Government. That is the conclusion that you have to reach.

So my point is, it is based on facts that I think have been misinterpreted or an audit report that has been misinterpreted. I would hope you would voluntarily agree that that ought to be modified and that that is not the conclusion you are suggesting to the subcommittee it ought to reach.

Mr. **Manikas**. We are certainly not suggesting, Senator, the overall mischarging rate would be nearly that high. What we are saying is we felt, as the *Sita* case amply demonstrates, there has been mischarging up to 62 percent in small samples. We say small samples, we know very well than the average couldn't possibly be that high; we have never suggested that. As a matter of fact, as your statement indicates, we say if it were only 1 percent, it would amount to a vast amount of money.

Senator **Cochran**. $60 million is what you said. That is outrageous, isn't it? How do you calculate $60 million could be taken by the company wrongfully with a 1-percent mischarging of time? There is no basis for that and you know it. I don't have any more questions.

Mr. **Brunner**. One percent of 6.2.

Senator **Cochran**. 6.2 what?

Mr. **Brunner**. Billion dollars.

Senator **Cochran**. That is the total contract price, that is not time and that is not an indication of man-hours. You know that is not the way to calculate that.

Mr. **Brunner**. Senator, we thought it was as good as anybody elses guess. We thought it was as good as the contractor in Mr. Erb's statement. Where does he come up with the 15,000 hours? It is a wild guess.

Senator **Cochran**. I don't have any other questions, Mr. Chairman.

Chairman **Roth**. I only have one additional question. What did you mean when you said, "When small samples were involved?"

Mr. **Brunner**. I think, Senator, what we were referring to was the fact that in this particular audit, DCAA only hit one little section, and you could not, therefore, conclude that this was a companywide practice. We are not suggesting that the 58 percent found in one floor check of one small section of a corporation was typical of the overall corporation. However, in that particular instance, as we suggested, that was just one piece of evidentiary material along with four people who gave us eyewitness testimony, some of whom signed affidavits and gave us the sheets themselves which tended to be corroborated with the check by DCAA.

We are not making any attempt to mislead the subcommittee which is why we spelled out exactly what the audit said on page 5 in the first audit, and we spell out on page 6, we go into the fact there was a second audit in which the DCAA people took back what they said in the first audit after a request for that audit by "60 Minutes" and the BGA.

[At this point, Senator Cochran withdrew from the hearing room.]

Chairman **Roth**. Senator Stennis, do you have any questions?

Senator **Stennis**. No, thank you very much.

Chairman **Roth**. Thank you very much. We appreciate you being here today.

At this time, I would like to call forward Sharon Sigalas, a former Ingalls employee, and Edwin Fite, a former Ingalls employee.

[At this point, Senators Cochran and Percy entered the hearing room.]

Senator **Cochran**. Mr. Chairman, are we going to go on through the lunchhour?

Chairman **Roth**. Yes; it is the Chair's intent to finish because the Senate will be going in later this afternoon. I intend to continue and complete today's agenda.

Senator **Percy**. Mr. Chairman, may I just commend BGA and Terry Brunner for what I consider to be a very thorough job. This has not been a pleasant task, but I think they have performed a great public service, and we appreciate it very much.

Chairman **Roth**. Sharon Sigalas and Mr. Fite, if you would come forward, please. Remain standing; raise your right hand. Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Ms. **Sigalas**. I do.

Mr. **Fite**. I do.

Chairman **Roth**. Please be seated. Ms. Sigalas, we would ask you to present your testimony.

TESTIMONY OF SHARON SIGALAS AND EDWIN FITE, FORMER INGALLS EMPLOYEES

Ms. **Sigalas**. Mr. Chairman, my name is Sharon Sigalas. I am a resident of Pascagoula——

Chairman **Roth**. Would you pull the microphone a little closer?

Ms. **Sigalas**. And a former employee of Ingalls Shipbuilding Division.

I worked beginning on June 2, 1976, as a clerk-typist at a salary of $550 per month. I had just turned 20 years old. I was married, and had a year-and-a-half old daughter. My department, submarine master planning and scheduling consisted of two cost centers, No. 439—nuclear—and No. 440—nonnuclear—with budgeted hours for four submarines—hulls 1209, 1210, 1212, and 1213—during the years I was employed there. The nuclear section consisted of approximately 10 to 15 people.

[At this point, Chairman Roth withdrew from the hearing room.]

Ms. **Sigalas**. My responsibilities were typing, filing, keeping personnel records, timecards and serving as a receptionist. I began filling out the timecards for the people who worked in both cost centers 439 and 440 approximately 1 week after I started work. Generally, my testimony was this. I was given a sample timecard, timecard charges and a computer run with the budgeted hours for our cost centers on it. This budget was a monthly projection with charges for our four hulls with additional budgeted hours for sick leave, personal business, jury duty, vacation and death in the family leave.

Each Friday from approximately June 1976 through November 1978, I filled out the timecards for my department except when I was absent or on vacation. On those occasions, another secretary filled out the cards.

After I completed the timecards, I took them around for each employee, including supervisors and section managers to sign while I waited. After all employees had signed the cards, the section managers would sign their cost center cards. This was done because company policy required a supervisor's signature.

[At this point, Chairman Roth entered the hearing room.]

Ms. Sigalas. As I stated before, I filled out the timecards from a computer run showing allocated budget hours for each hull. I was given the budget by my immediate supervisor, who told me to use it to complete the timecards. My procedure was as follows:

I would take the stack of timecards which were alphabetized and start with the top card, assigning hours to each employee. I would spread the hours out, usually allocating each person's work to at least two hulls since my supervisor had told me to make it look good until all the cards were completed, making sure I stayed within the budget hours.

I would complete the cards keeping a count of the hours I was using up as I went along. I was told how to allocate hours by my supervisor and the man above him, the director of submarine operations.

Once I was called to the submarine director's office to discuss timecards. When I got there, my supervisor was already there. The director showed me a copy of a computer run showing an overrun of hours on hull 1210 for our department for a particular month. He then asked me if I understood the importance of the budget run. I said, "No." So he explained it to me this way:

The hours left on the budget for hull 1209 had to be used up within a certain number of months after overhaul was completed or we would "lose them." Hull 1210 was going to be in the shipyard for a while yet so we needed to conserve hours on that hull in order to stay within our budget and on schedule. Hull 1212 hadn't even arrived in the yard yet so we could afford to use up hours on that hull since we were "the planning department." He explained to me that we were trying to get the hull 1213 contract so we had to look good on 1210, so I was not to overrun the budget for that hull again. He emphasized to me that a vital part of my job was to make sure that I didn't overrun the budget on any hull, especially 1210.

[At this point, Senator Percy withdrew from the hearing room.]

Ms. Sigalas. I never had any problems with people questioning the charges on their cards, until approximately September or October of 1977, when I took a timecard to an employee, Don Sigalas. He wasn't there, so I left the card on his desk. Every other time I had stood and waited for him to sign it. When he came back he brought me his timecard to me and told me that there must be a mistake on his card, because I had charged his time to a hull that he had not been working on. I told him that I was filling out the cards according to a budget. He informed me that I wasn't filling out his card like that.

I took the card and went into my supervisor's office and told him that Don Sigalas would not sign his card the way I had it filled out. My supervisor took the card and went down to Sigalas' section manager's office and closed the door. There was a very loud conversation which lasted for approximately 30 minutes. After that my supervisor came into my office and threw the card on my desk telling me to change it and charge Don's time to hull 1210. I did this and took the card to Don to sign it. He signed it and everything was fine.

The next week or so, I again filled out the timecards as I always have and Don Sigalas again refused to sign his card. This time the section manager called Don into his office and told him to "sign the timecard or get out of this department." He continued the loud conversation telling Don that he was just causing problems in our department. Don signed his card without any changes made to it. From that day forward, my supervisor and Don Sigalas' section manager started on what I would call a campaign to "get rid of Sigalas." After a couple of months, Don was fired for missing 4 hours of work the day he had gone home with a sore throat. I was shocked because nothing like that had ever happened in our department before. In fact, I knew of several instances in which individuals were paid for time they were off on personal errands, and the time involved was often a good deal more than 4 hours.

Shortly afterward, my supervisor came into my office and told me that I would be relieved from typing any documents regarding Don Sigalas. When I asked why, I was told that it was none of my business what happened to "my friend." I would like to add at that time he wasn't my friend, although later we did become friends and later on we were married.

All of this scared me so I went to talk to my father who had been general piping superintendent at Ingalls and had been at the yard for 20 years. I told him what was going on in our department. He seemed very concerned about my filling out the timecards according to a prepared budget rather than actual work done on the hulls. He said that charging people to a hull when they were actually out on personal business was fraudulently time charging. He informed me that as a secretary, I should not be filling out the timecards and that I should inform my supervisor that I had no intention of participating in the mischarging of time any longer.

I talked to my supervisor the next day and he told me that what went on in his department was none of my father's business. He said that if I wanted to keep my job I would keep department business in the department and continue to do what I was told. I did just that a while longer, but I was still worried. After talking to my father again, I wrote a letter to management reporting that I believed what I had been doing was wrong.

Almost immediately, I was called in to see one of the men in the upper management of our submarine program. He began to talk to me and I got real upset. I was afraid of losing my job. Ingalls had a way of "getting rid" of undesirable employees, which from my experience were employees who would not conform. I was asked if I understood the seriousness of my allegations. I told him that I was telling the truth and had no idea what the consequences for the department or for myself would be. We talked for a while and he told me that there was nothing illegal about preparing timecards from a budget because that's what a budget was for. He also told me that there was no reason that employees could not be given time off with pay when they were "good employees," which seemed odd to me since I thought Don Sigalas was a "good employee," but he had been let go for going home 4 hours early sick.

The man I met with concluded our meeting by asking me if I had sent a copy of this letter to anyone else. I told him no but that I had kept a copy in my desk. He asked me how I remembered so many dates, times, and people. I told him that when I started to work at Ingalls, my father said that I should keep a notebook to keep me covered in case something happened. I had kept up the notebook, putting in it what I thought were unfair practices in our department. I could then always have a "for instance" if I ever needed it. I was then told that I would not have to fill out the timecards anymore and not to worry about my job, and that no one would ever find out about the letter I had written. He told me that I should bring my extra copy of the letter and my notebook to him so that my supervisor would never see it.

I left feeling that I should never have written the letter to begin with and hoping everyone would just forget about the fact that I had written it. I gladly gave up the copy of the letter and my notebook, hoping the incident would be forgotten. But it wasn't. Back at my department, I was immediately removed from my secretarial duties. Within a day or two, I was called into my supervisor's office. When I got there, he opened his desk drawer and pulled out my handwritten letter. My supervisor told me that all of the things I had said in that letter were not any of my business, and that I shouldn't be running around telling them. He told me that I would remain in the department but would not be allowed to handle any personnel records or any confidential matters.

I was terrified of losing my job. I was 22 years old and was the sole supporter of my daughter and my husband. I said I was sorry for what I had done and I would never do anything like that again.

That was in approximately December 1977 or January 1978. I stayed at the shipyard for another 10 months in the same department. Though my supervisor eventually left our department shortly after January, his replacement made me his special project. He would say things to other people when I was around, like, "I wonder if Sharon will tell on us."

I finally went to internal placement and asked for a transfer to another department. I told them I would take a cut in pay or anything else just to get out of that department. Their response was that with so many girls getting laid off, I should be happy to have a job, and that I should do whatever it takes to keep my job.

I went back to my office and typed my letter of resignation. I quit Ingalls 2 weeks later without another job to go to. I was at that time separated and had filed for divorce, so I had to support my child and myself without a job, but I felt like my pride was more important, and I refused to be humiliated anymore.

Chairman Roth. Thank you. Rather than ask questions at this time, I will ask you to proceed, Mr. Fite.

Mr. Fite. Mr. Chairman and members of the subcommittee, my name is Edwin R. Fite. I have lived in Pascagoula, Miss., since June 1977, when I went there to work for Ingalls Shipbuilding as a diver/carpenter.

Divers are a necessary part of the shipbuilding process. There are frequent underwater assignments, mainly in the area of repairs and inspection. The need for divers is fairly constant. When I told the job interviewer for Ingalls in 1977 that I am a trained diver, he had me on the job in 4 days.

Chairman Roth. Would you speak into the microphone so everyone can hear, please?

Mr. Fite. Yes, sir. In March 1979, I made a dive into the mudtank of the nuclear submarine *Gato* to do some work on the anchor light. The mudroom is a small, machinery-filled room aboard each submarine. One of its purposes is to catch mud and debris coming in with the seawater used for various purposes aboard a submarine when underway.

[At this point, Senator Percy entered the hearing room.]

Mr. Fite. Once in the compartment, I found it very confining, muddy, and dark. I had to brace myself on the vertical rudder shaft, and in doing so, I found two cubes of metal approximately 1 inch on a side. There was no rust on the metal pieces and they appeared to be part of a bearing. I did not take the pieces with me as I wanted to leave them as a marker. I knew that 2 weeks prior to my dive, other Ingalls divers had been down examining the external rudder assembly to look for the cause of a jamming problem, and I associated these pieces of metal with this earlier dive. I informed my supervisor of what I had found and asked if it were possible that any debris had been left in the tank while the sub was in dry dock. He said, no, that was impossible. He said he would check with his supervisor regarding what I had found. In subsequent conversation with him, he told me his boss was not concerned about it, or words to that effect. I did not know what else I could do at the time, so I let it drop.

At a neighborhood party about 3 months later, I met the commanding officer of the *Gato*. At the time, I knew the *Gato's* sister ship, the *Tinosa*, which had undergone the same overhaul as being done on the *Gato*, had experienced rudder failure soon after going to sea. I thought about telling the *Gato's* skipper about the metal I had found on his boat, but I was afraid I would get into trouble with Ingalls if I discussed the situation with Navy officials. I had been told by my supervisor that we were not ever to tell Navy personnel about problems that we had found.

After talking it over with my wife, I decided it was best to bring the matter to the attention of Navy officials anyway, and I contacted a naval officer friend of mine. He arranged for a conference telephone conversation with the *Gato's* captain. I informed him of my findings at that time. This was late June, as I recall.

I was hoping I could provide the information without getting into any trouble. However, my role in the matter was immediately revealed by the Navy to Ingalls. The Navy has since reported that the disclosure of my identity was "Inadvertent."

The Navy made arrangements for a subsequent inspection of the compartment of the *Gato* within a few days. I was selected as the diver to go down with the Navy diver to make this inspection. During our inspection of the compartment, we found a large amount of metal debris. A lot of the material appeared to be same type of flange material, including a single large section of flange.

From this inspection, the Navy determined that the *Gato* had a shattered rudder bearing sleeve. The *Gato* went into drydock for an extended period. Almost immediately after the Navy dive, people I worked with and who I thought were friends of mine stopped talking to me. Conversation would stop when I entered a room and people seemed to avoid me generally. Within a few days of the Navy dive, I was questioned by Ingalls investigators regarding this matter. They already knew all about my being the person who blew the whistle.

The next layoff list that came out had my name on it, even though we had more diving work on the schedule than we could handle. In fact, at the very same time I was being laid off, new divers were being trained because of the workload. In addition, Navy regulations required nuclear-trained divers on many of the jobs. I had that training, but none of the new divers did. Still, I was the only one they picked to lay off.

Though I lost considerable salary when I was bounced out of diving—about $200 to $250 a week—I managed to stay employed at Ingalls by transferring to a lower-paying position. With the help of a sympathetic foreman. I hung on there for almost 6 months.

Finally, the company laid me off for good in February 1980. I have supported myself and my family on odd jobs ever since. Ironically, I was gone from the shipyard before the company had fixed the problem I had uncovered. The sub was still in drydock. I would be pleased to answer any questions you might have.

Chairman ROTH. Thank you, Mr. Fite. Ms. Sigalas, you understand that you are under oath and are expected to tell the truth?

Ms. SIGALAS. Yes.

Chairman ROTH. Mr. Fite, I ask you the same question, you understand you are under oath to tell the truth?

Mr. FITE. Yes.

Chairman ROTH. First of all, Ms. Sigalas, did you work in an office entirely separate from the planners and schedulers?

Ms. SIGALAS. Yes, sir, there were about 40 people in the department; 32 of them were out on what we call the floor, large open area. The section managers were in offices along the wall. They could see the men. I was in a corner office right outside of the manager's office, but I would have to get up and walk approximately 15 feet to even be able to see the area where the planners worked.

Chairman ROTH. So you were unaware of what work these people were actually doing on a day-to-day basis?

Ms. SIGALAS. Yes, sir, the only work I had actual knowledge of were the things I did typing for. I did do a little bit of typing for some of the planners who had different types of schedules and things they needed. Once they got it reduced, they might need something typed in. That is the only time I had any connection with what they were working on.

Chairman ROTH. But your superiors expected you to bill the hours according to the computer run plan; is that correct?

Ms. SIGALAS. Yes, sir.

Chairman ROTH. Who were these supervisors?

Ms. SIGALAS. The supervisors who——

Chairman ROTH. So instructed you?

Ms. SIGALAS. My supervisor was the manager of the submarine master planning and scheduling department, I had a meeting with the director of submarine operations which is who my boss worked for who told me about the importance of not overrunning the budget on hull 1210 at that time because it was especially important.

Chairman ROTH. Can you tell us at what level of supervision the director of submarine operations would be in the plant hierarchy?

Ms. SIGALAS. The vice president of submarine operations was in the same building I was. The director worked for the vice president and then my boss, who was a manager of submarine planning and scheduling worked for the director. There were several vice presidents.

Chairman ROTH. But the director of submarine operations reported to the vice president of submarine operations?

Ms. SIGALAS. Yes, sir.

Chairman ROTH. You were called in by this director and told, according to your testimony, that the hours left on the budget for hull 1209 had to be used up within a certain number of months after overhaul was completed or we would lose them. What did he mean by "we would lose them"?

Ms. SIGALAS. Apparently the way he explained it to me, there was a postoverhaul budget for mainly change order work, which in the planning and scheduling department we had a big input into the change order function. We had hours left after the submarine left the shipyard in which to make change orders and those type of things. What I understood was we were given so many months to do all the change orders and the budget brings it out for hours. We had three overhaul budgets. We had hours before submarine got there and after submarine left.

Chairman ROTH. Much of what you have told us, did they involve the man who is now your husband? Is your testimony here based upon your own experience, your own recollection or has it been influenced by your husband?

Ms. SIGALAS. The things in my statement are what I remember personally. I knew I was going to be testifying under oath, and I wouldn't testify to anything that I don't actually remember happening from my own experiences.

Chairman ROTH. You told us that your last supervisor made you his special project. What do you mean by that?

Ms. SIGALAS. He was a section manager at the time all of this happened. Once my manager was transferred, he was promoted to manager. He was also Don Sigalas' section manager at the time everything happened. He would make little remarks to me like, "Sharon's going to tell on us; don't say that in front of Sharon." He also had physically, I felt like it was harassment. He would lean up against me, touch me, pinch—whatever you want to call it. He made a point of making things miserable for me.

I would say something to him like, "leave me alone; let me do my job." He would say, "I'm not good enough for you," or things like that.

Chairman ROTH. You weren't actually fired, were you?

Ms. SIGALAS. No, sir.

Chairman ROTH. Do you consider your resignation voluntary?

Ms. SIGALAS. No, sir. I didn't want to lose my job. I didn't want to quit. I had a 3-year-old child at the time. Like I said, I was separated; I needed the money. First of all, I went to labor relations and explained to the manager of labor relations what was going on in the department as well as I could about the verbal harassment with "Sharon's going to tell on us," and the sexual harassment. He did have a meeting with my manager and told him to cut it out. The manager never did. I then went to internal placement and asked for a transfer. I was a labor grade 6 at the time, and I offered to take a cut in labor grade to go back to a 5 as a typist and was told I should be glad I had a job with so many people getting laid off, just go back and do whatever it took to keep it. I then resigned from the company.

I filed for unemployment and after a hearing with a referee, the referee statement in an opinion was that I had exhausted every avenue to correct the situation without quitting and since he felt like I had done everything I could that I was allowed unemployment compensation.

Chairman **Roth.** Were you ever encouraged by the company to come forward if you saw something wrong in the plant?

Ms. **Sigalas.** No, sir. The one time that I did write a letter to the vice president of submarine operations, it ended up with another man who was in program management. I was made to feel like I had done something wrong by accusing people of things.

Chairman **Roth.** You wrote the letter to a vice president?

Ms. **Sigalas.** Right.

Chairman **Roth.** Which vice president was that?

Ms. **Sigalas.** Of submarine operations.

Chairman **Roth.** Did he ever see that letter?

Ms. **Sigalas.** I never talked to him about the letter. I personally delivered the letter to his office and laid it on his desk. It was sealed in an envelope with his name on the outside. The next day I called down to program management and the man who talked to me told me he handled things like that for the vice president and had been requested to handle my problem.

Chairman **Roth.** Mr. Fite, how much diving experience did you have at the time you were removed from your diving at Ingalls?

Mr. **Fite.** Fifteen years.

Chairman **Roth.** How did your experience compare with that of other divers?

[At this point, Senator Stennis withdrew from the hearing room.]

Mr. **Fite.** How do you mean, sir?

Chairman **Roth.** Were there divers kept on with less experience than you had?

Mr. **Fite.** Yes, sir; they started a training program some time in August, training two divers to help out with the additional work of the oil rigs that were coming in. These new divers had little or no prior experience.

Chairman **Roth.** You testified that you thought your job would be on the line if you went to the Navy with your report. Why did you think that?

Mr. **Fite.** My supervisor and general foreman both told me on different occasions, if you value your job, don't talk to anyone but us.

Chairman **Roth.** Did that include not talking to the Navy?

Mr. **Fite.** That includes the Navy. They were referring to the Navy at the time.

Chairman **Roth.** In other words, they were explicitly referring to——

Mr. **Fite.** Yes, sir.

Chairman **Roth.** What level of supervision gave you those instructions?

Mr. Fite. Supervisor, above him foreman, and above him general foreman. So the general foreman and supervisor both indicated to us on different occasions.

Chairman Roth. Mr. Fite, do you have any knowledge about mis-charging or cross-charging?

Mr. Fite. Yes, sir. One of the divers was a clerk in his spare time and made out the timecards. I overheard conversations between him and the supervisor concerning timecards. All of my timecards were made out in the office. I signed blank cards and turned them in.

Chairman Roth. You say you signed blank cards?

Mr. Fite. Yes, sir.

Chairman Roth. Was that according to company policy for you to sign blank cards?

Mr. Fite. It was a department policy. I can't speak for the company policy.

Chairman Roth. Were you ever advised by the company that it was your responsibility to fill out and sign your own timecards?

Mr. Fite. We signed our own timecards. Filling it out most of the time was the supervisor or his clerk.

Chairman Roth. Filling out and signing.

Mr. Fite. Many times we didn't know which hull to charge our time to.

Chairman Roth. How many timecards were handled in—was it a joint department you——

Mr. Fite. We worked under the carpenter shop on the east bank.

Chairman Roth. How many timecards were handled there?

Mr. Fite. Approximately 10 and 15, possibly 20 cards.

Chairman Roth. Would there be days when you worked on or dove on several ships and how would they handle your time?

Mr. Fite. The hulls we worked on didn't necessarily correlate with the hull number put on the timecards.

Chairman Roth. You know that from personal observation?

Mr. Fite. Yes, sir; I asked why they did it.

[At this point, Senator Stennis entered the hearing room.]

Chairman Roth. Who did you complain to?

Mr. Fite. I never complained. I was curious. It didn't make sense to work on a particular hull and charge the time to another hull.

Chairman Roth. What did they tell you as an explanation?

Mr. Fite. They said each hull had a certain number of man-hours budgeted to that hull and they couldn't exceed that number. They juggled the man-hours accordingly to keep from exceeding the budget.

Chairman Roth. So the timecards were kept, according to what you were advised, according to budgetary needs?

Mr. Fite. Yes, sir.

Chairman Roth. Mr. Fite, were you specifically fired for your action with respect to the submarine?

Mr. Fite. No, sir; I wasn't fired. I was given a choice under the guise of reduced work force to either transfer to another department or take immediate layoff.

Chairman Roth. Do you personally believe that it was, in fact, however—dismissal was based upon the fact that you had disclosed this information on the submarine?

Mr. **Fite**. Yes, sir, I do. In talking to some of the other carpenters who transferred with me, they were told by their supervisors it was only a temporary thing; they would be back in their departments as soon as possible.

Chairman **Roth**. How about you?

Mr. **Fite**. No one mentioned anything about ever returning back to the carpenters, much less diving again.

Chairman **Roth**. Mr. Fite, did the Navy ever acknowledge in any way or by any means that the information you supplied was valuable?

Mr. **Fite**. Yes, sir. The Navy commander indicated, through a letter written to the commander of the Submarine Force, Atlantic Fleet, that I saved the Navy $420,000 and this was later revised to $690,000 in actual cost. The commander of the Submarine Force agreed with him and they recommended that I receive an award from the Navy.

In the end, I didn't get anything except the Navy's explanation that they have no program for recognizing such civilian contributions.

Mr. **Weiland**. Mr. Chairman, if I might just interject. We have copies of official Navy correspondence that I would like to insert in the record at this point, if I may, including a memorandum dated November 9, 1979, from the commanding officer, U.S.S. *Sunfish* to the commander, Submarine Forces, U.S. Atlantic Fleet, where, indeed, the recommendation is made for a $10,000 reward to Mr. Fite in recognition of "the savings to the U.S. Navy of $420,000 based on information he provided."

Chairman **Roth**. Thank you. That will be included without objection.

[The information referred to was marked "Exhibit No. 2," for reference, and follows:]

EXHIBIT No. 2

U.S.S. SUNFISH (SSN-649),
New York, N.Y., November 9, 1979.

From: Commanding Officer, U.S.S. *Sunfish* (SSN-649).
To: Commander, Submarine Force, U.S. Atlantic Fleet.
Subj: Monetary Award in case of Mr. Edwin R. FITE, 373-36-1477; recommendation concerning.
Ref: (a) NAVSEAINST 5305.1, Incentive Awards Program for Military and Civilian Personnel.
(b) NAVSEAINST 5305.2, Incentive Awards System for Military and Civilian Personnel.
Encl: (1) Chronology of discovery of USS GATO (SSN615) Rudder Bearing failure.

1. The purpose of this letter is to outline the background of a major material deficiency discovery on USS GATO (SSN615), and to recommend that the U.S. Navy make an appropriate monetary award in the case of Mr. Edwin R. Fite. As detailed in enclosure (1), Mr. Fite identified a potential (and it was confirmed) major problem on the USS GATO. Although not conclusive it appears that his information may have been a factor in job reassessment which has resulted in a severe personal hardship for him. By his actions, however, the U.S. Navy and the Submarine Force have been able to pre-plan a major work item with a significant overall savings in both time and money.

2. References (a) and (b) (which are not held by SUNFISH) appear to address monetary awards for civilians. This specific case is unique as Mr. Fite does not work directly for the government. Notwithstanding, it is highly recommended that a cash award (under references a, b or other appropriate directive) of $10.000 be made to Mr. Edwin R. Fite as recognition of the savings to the U.S. Navy of $420,000 (estimated in enclosure (1)) based on information he provided.

3. It is recognized that this letter is not the normal format for identification and recommendation of cash awards, nor is Commander, Submarine Force Atlantic necessarily the action addee. Due to the unique characteristics of this case, I feel a personal responsibility to formally document the issues and make this recommendation. The decision to present his information to the Navy was not an easy one for Mr. Fite. He firmly believes, both by rumor and treatment, that his job security (or lack of it) is a direct result of his actions. He has not asked for nor does he expect any award or formal recognition for his act. I feel he deserves more.

R. N. LEE.

[First Endorsement on CO, U.S.S. *Sunfish* (SSN-649) letter of Nov. 9, 1979]

From: Commander Submarine Force, U.S. Atlantic Fleet.
To: Chief of Naval Operations.
Subj: Monetary Award in the case of Mr. Edwin R. FITE, 373-36-1477; recommendation concerning.

1. Readdressed and forwarded for consideration. The circumstances of this case warrant favorable consideration of cash awards can be made to civilian personnel such as Mr. Fite.

2. A copy of this letter is forwarded to the Naval Inspector General as a matter of possible concern.

R. C. AUSTIN,
Chief of Staff.

U.S.S. SUNFISH (SSN-649),
New York, N.Y., February 23, 1980.

From: Commanding Officer, U.S.S. SUNFISH (SSN-649).
To: Chief of Naval Operations.
Subj: Monetary Award in case of Mr. Edwin R. Fite, 373-36-1477; additional information concerning.
Ref: (a) Commanding Officer, U.S.S. *Sunfish* (SSN-649) letter dated November 9, 1979.
Encl: (1) Commanding Officer, U.S.S. *Sunfish* (SSN-649) letter of November 9, with First Endorsement dated February 6, 1980.

1. Reference (a), included with the First Endorsement is enclosure (1), recommended that a monetary award in the amount of $10,000 be made to Mr. Edwin R. Fite, 373-36-1477. Since the facts of reference (a) were outlined, the U.S.S. *Gato* has been drydocked, rudder repairs completed (along with much other parallel drydock work), and the ship undocked 9 days early from Ingalls Shipyard original schedule. As a result the *Gato* delivery schedule has been shortened which will mean an additional net savings to the government of approximately $270,000 (9 days times approximately $30,000 per day average shipyard costs).

2. On February 15, 1980, Mr. Fite's employment at Ingalls Shipyard was terminated. He is presently unemployed. As noted in enclosure (1) he has not worked as a diver since September 10, 1979.

3. It is highly recommended that the cash award of reference (a) (and favorably endorsed by the Commander Submarine Force U.S. Atlantic Fleet) be authorized as soon as possible.

R. N. LEE.

U.S.S. SUNFISH (SSN-649),
Miami, Fla., June 3, 1980.

From: Commanding Officer, U.S.S. *Sunfish* (SSN-649).
To: Chief of Naval Material.
Subj: Monetary Award in the case of Mr. Edwin R. Fite, 373-36-1477; Information and recommendation concerning.
Ref:
(a) CO, U.S.S. *Sunfish* (SSN-649) ltr of Nov. 9, 1979 w/endorsement.
(b) CO, U.S.S. *Sunfish* (SSN-649) ltr SSN-649:RNL:rww 1000 Ser 60 of Feb. 23, 1980.
(c) CNO ltr Ser 09B22/548480 of Mar. 21, 1980.

Reference (a) recommended a monetary award in the amount of $10,000 to Mr. Edwin R. Fite based on a savings to the Navy estimated to be $420,000 from information he provided. This recommendation was forwarded for favorable consideration to the Commander Submarine Force, U. S. Atlantic Fleet.

Reference (b) recommended that action on the case award be authorized as soon as possible. This letter also pointed out that an additional savings to the government of about $270,000 had been realized. It further provided information that Mr. Fite's employment had been terminated and that he was unemployed.

Reference (c) forwarded references (a) and (b) to the Chief of Naval Material and stated that a thorough investigation was appropriate. By way of additional information, a complete investigation of this entire matter (less the recommendation for a cash award) was conducted by the Naval Investigative Service in the July/August 1979 time frame. Additionally, RAdm W. E. McGarrah (SEA 05) was the Supervisor of Shipbuilding, Pascagoula, MS and was familiar with all aspects of this case.

Although a skilled craftsman and professional diver, Mr. Fite still remains unable to find employment. He feels strongly that his job was "terminated" at Ingalls primarily for providing information to the Navy which led to the early detection of a major material failure on the U.S.S. *Gato* (total failure of the rudder bearing sleeve). Administration of the cash award recommendation paperwork has now taken 7 months. It is recommended that this cash award be authorized as soon as possible.

R. N. LEE.

Chairman ROTH. Senator Cochran.

Senator COCHRAN. Thank you, Mr. Chairman. Mr. Chairman, earlier in my questioning of a previous witness, I referred to audit by date and a memorandum by date. Could I be assured that copies of those two documents will be included in the record at the appropriate place to illustrate that question and answer?

Chairman ROTH. So ordered.

Senator COCHRAN. I thank the chairman.

Ms. Sigalas, you left the employment of Ingalls in what year—1978?

Ms. SIGALAS. Right.

Senator COCHRAN. So you have not actually worked for the company in 5 years; is that correct?

Ms. SIGALAS. That's correct.

Senator COCHRAN. At the time you were working, you talked about this letter that you composed listing events because you felt one day they might come in handy, and they did help keep you familiar with the facts even though time had passed and a normal person might have forgotten the details of times, names, places and things. You were able to remember because you had written this letter; is that right?

Ms. SIGALAS. I am not sure I understand.

Senator COCHRAN. You made notes of it because at the time you made the notes you knew what the facts were; is that right?

Ms. SIGALAS. The notebook that I was talking about I used to compose the letter showing examples of where other employees had been given time off and paid as if they were there for personal reasons.

Senator COCHRAN. I am going to send you a copy of what purports to be a letter down, and I am going to ask you if this is a letter that you wrote?

[Witness tendered document.]

Ms. SIGALAS. I have seen this. This is not the letter that I wrote.

Senator COCHRAN. What is that?

Ms. SIGALAS. I honestly don't—this is my handwriting.

Senator COCHRAN. In its entirety?

Ms. SIGALAS. In its entirety. Every bit of it is my handwriting. I can't honestly say I remember writing this particular set of pages.

Senator COCHRAN. It bears a date on the last page and some initials there. I think it is January of 1978.

Ms. SIGALAS. Right.

Senator COCHRAN. With the initials JFS. Who is JFS?

Ms. SIGALAS. I don't have any idea. Apparently it was somebody who saw the letter. There was a man working in the submarine project with those initials. I had seen it on several memorandum. Back then, you had to check off and my boss also got the memorandums but I don't know who it is.

Senator COCHRAN. Could it have been J. F. Smith?

Ms. SIGALAS. Right, that is who I was referring to. I don't know he is the one who wrote that, but he was in the submarine project and those were his initials.

Senator COCHRAN. This memoranda contains, does it not, a recitation of names of persons and times when they were not at the shipyard and what you perceived to be unauthorized absences that you were calling to the attention of management; is that correct?

Ms. SIGALAS. Yes, sir.

Senator COCHRAN. That was written in 1978 when you were familiar with the facts as they existed then; is that correct?

Ms. SIGALAS. Yes, sir.

Senator COCHRAN. Would you read to the subcommittee the last paragraph of that memorandum?

> I want to make it clear even though I physically filled out the timecards, I do not determine the time charges. I fill out the cards per instruction of the section managers and the manager of my department.

Senator COCHRAN. The manager at that time, or some point when you were working there performing that clerical function was a fellow named Poole, was it not?

Ms. SIGALAS. Yes, sir.

Senator COCHRAN. He was called Joe Poole?

Ms. SIGALAS. Yes, sir.

Senator COCHRAN. His name really was James O. Poole. He was called Joe because of his initials J. O.; right?

Ms. SIGALAS. Yes, sir.

Senator COCHRAN. Isn't it really true he would prepare the time that the employees worked on a sheet of paper and hand it to you indicating the name, the hull number, and the hours worked to be charged and you were to fill in the timecards from the information contained on that sheet of paper prepared by him?

Ms. SIGALAS. No, sir; that is not true.

Senator COCHRAN. Mr. Chairman, I don't know who is telling the truth. I do want to suggest that we ought to have in the record a statement by J. O. Poole. I have a copy of an affidavit that has been submitted to me dated April 29, 1983, and I ask that it be included in the record at this point.

Chairman ROTH. Without objection.

[The statement and affidavit referred to was marked "Exhibit No. 3," for reference, and follow:]

EXHIBIT No. 3

JANUARY 13, 1978.

To whom it may concern: It was recently brought to my attention by D. P. Sigalas that several violations of time card procedures have taken place in my department (Submarine Master Planning & Scheduling). Due to my direct involvement in the preparation of time cards I felt it is proper to bring these activities to the attention of management.

CASE 1

One Friday afternoon during the first part of May 1977, Winston Dunn and D. Sigalas went to the Castaways Restaurant for lunch. Later in the afternoon W. H. Steiner was inquiring as to Dunn's whereabouts—no one knew where he was. Dunn's time for that afternoon was charged directly to the hull. The following Monday Mr. Dunn was questioned as to his whereabouts on the previous Friday. Mr. Dunn admitted that he had gone home from the Castaways at lunch—his time card charges for the previous week were not changed.

CASE 2

On November 11, 1977, I noticed W. H. Steiner was not present in the office during the afternoon hours. On several occasions I looked for him to assist me in time card preparation. At 4:15 p.m. I placed the unsigned time cards for Mr. Steiner's section on his desk and went home. Monday morning, the 14th, Mr. Steiner informed me that he had been in a late meeting the previous Friday.

Later I was informed by D. P. Sigalas that on the 11th Mr. Steiner had informed R. S. Edwards that he was attending his aunt's funeral. Mr. Sigalas informed me that Mr. Steiner had in truth been at his aunt's wake—the funeral was the 13th. Mr. Steiner's time card charges for the week were charged directly to the hull. None of his time was charged to personal business or death in the family.

CASE 3

One Thursday in the first part of November, Winston Dunn went to Pensacola, Florida, to pick up a camper he had ordered or/and purchased. Mr. Dunn's time charges for the week were charged directly to the hull. None of his time was charged to personal business.

CASE 4

On November 21, 1977, W. H. Steiner went to New Orleans to pick up some parts for his boat. He left the shipyard at approximately 8:00 a.m. and returned at approximately 3:00 p.m. This time charges for the week were charged directly to the hull. None of his time was charged to personal business.

On several other occasions I was aware that an employee would be out of the office for extended periods of time and I was instructed to fill out their time card as if they were here. Such cases are:

(1) M. A. Boykin was out of the office for 2 days to take care of personal business. But on Friday I was instructed to fill out his card as if he was at work—charging his time directly to the hull.

(2) S. W. Edwards left after lunch on Friday to go to a Shriners' parade in Biloxi. His time was charged directly to the hull.

(3) J. D. Maultsky was out for personal business with no charge for personal business entered on his card.

(4) W. H. Steiner has been out of the office on several Fridays when he was never reported as being absent.

I wish to make it clear that even though I physically fill out the time cards I do not determine the time charges. I fill out the cards per instructions of the section manager's and manager of my department.

S. W. Sutherland.

STATE OF MISSISSIPPI, COUNTY OF JACKSON

AFFIDAVIT

Comes now, James O. Poole, also known as JOE POOLE, who having first been duly sworn upon his oath, deposes and says:

1. I was the Manager of Master Planning and Scheduling for Submarines during the years 1975 to and including 1978. During this time, I was responsible for all master planning and scheduling activities, and have personal knowledge of all facts set forth in this Affidavit. If sworn as a witness at trial, I could competently testify to the factual statements set forth in this Affidavit.

2. Don Sigalis was not fired because of any refusal to cross-charge time between different contracts. In fact, cross-charging was never discussed at the time of Mr. Sigalis' discharge. Sigalis had failed to attend a scheduled meeting

concerning test sequence networks which Sigalis developed for submarine overhaul work. The meeting was scheduled with ISD personnel and Navy personnel from the ship's force. The unexcused absence resulted in an indefinite suspension from employment. When Mr. Sigalis was called back in with the intent of reinstating his employment following a short suspension, Mr. Sigalis was insubordinate at a meeting held in the Labor Relations offices of the Administration Building. I decided to terminate Mr. Sigalis' employment permanently because of the insubordination.

3. Sharon Sutherland worked for me as a Technical Aide while I was the Manager of Master Planning and Scheduling for submarines. Her responsibilities included the preparation of time cards from time sheets that I gave her. Each week, I kept track of the assignments of the employees working in my department, based upon information provided by the Supervisors and Section Managers. During this time, I had no reason to doubt any of the time charges based upon my evaluation of the end products resulting from the work performed. I would then prepare the time sheets and give them to Sharon Sutherland. In turn, she would then prepare the individual time cards for the employees. The time work sheets that I prepared listed employees by name, hull number and hours worked. This included all of their time charges, including vacation, sick leave, etc. At no time was Sharon Sutherland or Donnie Sigalis instructed by me to improperly cross-charge time.

Sometimes work that was being performed for several different hulls, such as the preparation of test sequence networks, would be used for all submarine hulls at different rates of frequency. In such cases, the actual hours worked in the preparation of the networks would be charged to the various hulls in direct proportion to the use of such test networks on the respective hulls. This could include assignment of work hours spent in the development of such test networks to be used on hulls for which we had advance planning contracts. This constituted a portion of the advance planning that would be completed prior to the arrival of the submarine hulls for overhaul.

4. To my knowledge, no one in my department was ever instructed to improperly cross-charge time. Certainly, I never gave any such instructions.

Further the affiant sayeth not.

Dated this the 29th day of April, 1983.

JAMES O. POOLE.

Subscribed and sworn to before me, the undersigned Notary Public, on this the 29th day of April, 1983.

RUTH E. SNELL,
Notary Public.

My Commission Expires November 7, 1983.

Senator COCHRAN. Mr. Chairman, without taking up the time of the subcommittee, I simply would summarize from this affidavit by saying it says with respect to the keeping of time and allocation of charges, "Sharon Sutherland"—which is who you were before you married Don Sigalas.

Ms. SIGALAS. Right.

Senator COCHRAN [reading]:

> Worked for me as a technical aide while I was a manager of Master Planning and Scheduling for submarine. Her responsibilities included preparation of timecards from timesheets that I gave her. Each week I kept track of the assignments of the employees working in my department based upon information provided by the supervisors and section managers. During this time, I had no reason to doubt any of the time charged based on my evaluation of end products resulting in the work performed. I would then prepare the timesheets and give them to Sharon Sutherland. In turn, she would then prepare the individual timecards for the employees. The time work sheets I prepared listed the employees by name, hull number and hours worked. This included all their time charges, including vacation, sick leave, et cetera. At no time was Sharon Sutherland instructed by me to improperly cross-charge time.

Let me ask you about this, Ms. Sigalas. As the time you wrote the memorandum reciting what you did in connection with the keeping of time and the allocation of time, this was more near to the date of the actual event than either your statement on 60 Minutes in April of 1983 or the statement you submitted to the subcommittee today; is it not?

Ms. **Sigalas.** Yes, sir.

Senator **Cochran.** I have no other questions, Mr. Chairman.

Mr. **Weiland.** Ms. Sigalas, before you leave, so the record is clear, there was another letter you referred to in your statement; is that right?

Ms. **Sigalas.** Yes, sir. The letter I wrote was to the vice president of Submarine Operations. My father told me that is who I should direct the letter to. I said in there things were going on that I had been told were wrong, although I didn't actually know; I had never seen standard procedures to back up what people were telling me were wrong. It didn't call names; it didn't state very many phrases since I might say something like, "For a week, I was told to hold an employee's timecard until Monday and fill it out as though he had been there all week," and Monday I had to get it signed and over to the payroll before 10 o'clock.

In that letter, it was more or less a personal thing I was trying to tell him; I thought I was doing something wrong and needed to tell somebody.

Mr. **Weiland.** You don't have a copy of that?

Ms. **Sigalas.** No.

Mr. **Weiland.** You don't have a copy of that letter you have in front of you either, do you?

Ms. **Sigalas.** No; I didn't have a copy of that until a week ago, I guess, I was shown a copy of that and told the man who discussed the situation with me had apparently—somebody gave him, Mr. Smith, a copy of that.

Mr. **Weiland.** The second copy, the second letter that you have in front of you was retained by the company?

Ms. **Sigalas.** Right.

Mr. **Weiland.** And eventually you were shown that letter again recently; is that right?

Ms. **Sigalas.** About a week ago.

Mr. **Weiland.** The other letter you are testifying about, you gave to the company; you do not have a copy of that and the company has never produced that for you; is that right?

Ms. **Sigalas.** No, sir; I never asked them for it. Whenever they asked me for my copy, I gave up my copy along with the original I had written.

Mr. **Weiland.** You gave up your notebook, too; is that right?

Ms. **Sigalas.** Yes, sir.

Mr. **Weiland.** Did you ever get that back?

Ms. **Sigalas.** No, sir; they cleaned out my desk while I was down at the program manager's office that next day.

Chairman **Roth.** Thank you very much.

Senator **Cochran.** Mr. Chairman, I have a few questions of Mr. Fite. Mr. Fite, you were represented at Ingalls by the carpenter's union?

Mr. **Fite.** Yes.

Senator **Cochran.** Isn't it part of the agreement of the union if there is a layoff, the most junior employees represented by the union will be laid off first; is that correct?

Mr. FITE. That is correct.

Senator COCHRAN. You did do some diving, but you were a carpenter and were represented by the union?

Mr. FITE. That is correct, but I did more diving than I did carpentry.

Senator COCHRAN. At the time you were laid off, isn't it true there were some 17 carpenters laid off at the same time?

Mr. FITE. I don't know how many were actually laid off. Some were transferred and some were laid off.

Senator COCHRAN. Do you recall that there were a number of carpenters laid off at the same time you were laid off whether it was 17, 15, 10, or whatever number?

Mr. FITE. Yes, sir.

Senator COCHRAN. There were others laid off?

Mr. FITE. Yes, sir.

Senator COCHRAN. Under the terms of that agreement with the union; is that right?

Mr. FITE. That's correct.

Senator COCHRAN. You were the second most junior member of the carpenters who were represented by the union. If only two employees had been laid off represented by the carpenter's union, you would have been one of them?

Mr. FITE. No, sir; as a diver, the union filed a grievance stating that for reasons of skill and ability that I should be exempt from the layoff.

Senator COCHRAN. The point was that dispute was worked out but not to your satisfaction.

Mr. FITE. I don't know if it was ever worked out. I never did hear any results.

Senator COCHRAN. You were actually transferred to another job at no reduction in pay; you were given a job as a joiner and worked 6 months there; isn't that true?

Mr. FITE. No, sir; I took a $250-a-week cut in pay as a diver.

Senator COCHRAN. As a diver?

Mr. FITE. Yes, sir.

Senator COCHRAN. But you were working as a carpenter and you continued to work at the same rate of pay prescribed by the carpenter's union contract; isn't that correct?

Mr. FITE. That is not correct. My average salary in the 2½ years as carpenter/diver indicated that I took a $200- to $250-a-week paycut to go to the joiners.

Senator COCHRAN. The point is, after you gave this information to a supervisor that you described about the submarine hull that you thought was defective and should be brought to somebody's attention, you were not fired at that time—is that correct?—but later when you brought the matter to the attention of the Navy, you claimed you were fired because you gave that information to the Navy?

Mr. FITE. I was never fired; no, sir. I was transferred to another department.

Senator COCHRAN. So your termination from the company was not connected in any way with your disclosure of information about a defective part of a submarine hull, was it?

Mr. FITE. At that time, hull 85 was finishing up. There were more joiners than any other craft. It was common knowledge when HL-85 was finished, the largest layoff would take place in the joiner department.

Senator COCHRAN. That is what happened. There was a sharp downturn, as a matter of fact, in the level of employment at the yard generally. Employment went from some 10,000 to 6,000 during this period of time and a lot of people were being laid off because of lack of work; isn't that right?

Mr. FITE. That's correct, but not in the diving department. We were training in welding and taking additional training to be ready for the oil rigs when they came in. At the time I was laid off, every ship was still there, and the time I was laid off, the nuclear submarine *Gato* was in drydock, which required the service of nuclear-trained divers.

Senator COCHRAN. But the point is, you were represented by the carpenter's union and you were a carpenter; isn't that correct?

Mr. FITE. That's correct; but I was a carpenter/diver and this was my correct designation. The carpenter's local No. 569 represents divers, joiners, pile drivers, as well as carpenters.

Senator COCHRAN. I have no other questions, Mr. Chairman.

Chairman ROTH. Is it correct you were hired as a diver?

Mr. FITE. Yes, sir, I was in Columbia, S.C., and interviewed. They saw I was a carpenter and also a diver. He made a long-distance phone call to the general foreman at Ingalls, I later found out and they paid my way to Pascagoula, Miss. I was put up for 2 weeks; I was hired specifically to be a carpenter/diver.

At the time, two of the divers that were later trained in the last months I was at Ingalls were presently employed at Ingalls when I went there.

Chairman ROTH. Would you repeat that? You say they were being trained——

Mr. FITE. The last month before I was transferred into the joiners department, the two men who were being trained as divers were employed when I came to work at Ingalls in 1977. They were not considered for the position at that time because of their lack of diving ability.

Mr. WEILAND. Mr. Fite, you mean two of these people who were being trained later on had worked for the company earlier at the time you were hired as a diver; is that what you mean?

Mr. FITE. That is correct.

Mr. WEILAND. Rather than put those people in the diving position, you were hired and brought in as a diver; is that what you mean?

Mr. FITE. That is correct, sir.

Chairman ROTH. I believe that completes the questioning. Thank you very much.

At this time, I would like to call forward Fred O'Green, chief executive officer of Litton Industries, and Leonard Erb, president, Ingalls Shipbuilding.

Gentlemen, if you will stay standing. As you well know, under our rules, all witnesses are required to be sworn. Please raise your right hands.

Do you swear the testimony you will give before the subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. O'Green. I do.
Mr. Erb. I do.
Mr. St. Pe'. I do.
Mr. Robbins. I do.

Chairman Roth. Mr. Erb, I would ask that you first introduce those that are accompanying you.

[At this point, Senator Cochran withdrew from the hearing room.]

TESTIMONY OF FRED W. O'GREEN, CHIEF EXECUTIVE OFFICER, LITTON INDUSTRIES, AND LEONARD ERB, PRESIDENT, INGALLS SHIPBUILDING; ACCOMPANIED BY JERRY ST. PE', VICE PRESIDENT, PUBLIC AND INDUSTRIAL RELATIONS; AND ED ROBBINS, VICE PRESIDENT, ADMINISTRATION

Mr. O'Green. May I be the first speaker in our presentation to you?

Mr. Chairman and members of the subcommittee, I am Fred W. O'Green, chairman of the board and chief executive officer of Litton Industries, parent company of Ingalls Shipbuilding. We are pleased to have the opportunity to be here to appear before your subcommittee today. I am accompanied here today by Leonard Erb who is senior vice president of Litton Industries and is president of Ingalls. He has with him Mr. Robbins. When Mr. Erb speaks, he will introduce them to you and their appropriate positions.

Mr. Erb is going to cover the specific subjects which you asked us to present to the subcommittee. My presentation to you will state the position of Litton Industries and that of our board of directors.

We have a prepared statement which has been submitted for the record, Mr. Chairman.

Chairman Roth. It will be included as if read.[1]

[At this point, Senator Cochran entered the hearing room.]

Mr. O'Green. I have 40 years of experience in defense matters which I feel are pertinent to these particular hearings. That experience includes my first 12 years as an engineer at the Naval Ordnance Laboratories working on underwater weapons and application of nuclear warheads to these weapons.

I mentioned the latter because of the complexity of the first inclusion of a warhead in a naval weapon. I am sure you recall the difficulty between DOD and all the things that happened in that process.

That was followed by 7 years at Lockheed Aircraft Co. When I worked there, I was a technical director in charge of the U.S. Air Force space program which was charged with bringing our first stabilized satellite system into orbit following Sputnik. I would like to highlight that this particular work was conducted in an environment of international technological war under extreme urgency to satisfy national intelligence missions. I remember no time in my life when I was under more pressure. We were most productive under those circumstances, and I think most cost effective.

Following that, I spent 20 years at Litton Industries. The first 10 years at Litton was in our International Defense Electronics Group. Seven years of that I served as head of that activity.

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[1] See p. 209 for the prepared statement of Leonard Erb.

In 1979, I was given the added responsibility for our 137 marine activities which included the principal part of Ingalls Shipbuilding activities.

Although I became Litton's president and chief executive operating officer in December 1972, the principal part of my time from 1971 to 1978 remained devoted to Ingalls' activities. I participated during that period part-time as the president of that organization in bringing private sector sponsored industrial capability to fulfillment in a shipyard which today is generally recognized as a national asset. I headed Litton's leadership role in settling the shipbuilding claims against the Government in the 1970's, a major accomplishment for industry/Government relations requiring the extensive participation of the Navy, the administration, and the Congress.

My experience is set forth only to indicate that I have a good deal more than a passing interest in the defense procurement process and our shipyard activities. I would say that in my experience throughout the whole of the defense procurement process there is no procurement the Department of Defense does that is more complex than that of purchasing an advanced technical complicated warship. I really include those things which go across the board—aircraft procurement, arms procurement, space procurement, electronic procurement, most of those engaged in Litton Industries.

I have another observation I will make after having listened to some of the testimony given, Mr. Chairman. That is, it has been my personal experience that the individuals who have not had indepth senior experience in this complex industrial process have little success in gathering representative information of the operations that we are talking about, and they are unable to draw what I consider valid conclusions about it. I think it is a very difficult point because of the complexity and immensity.

Litton has been a defense contractor since we were organized in 1953, founded by Mr. Thornton. We, like others, have experienced all the inefficiencies of this system which appear in many, many forms.

The inefficiencies of that system notwithstanding, Litton recently completed the delivery of the CG-47 *Ticonderoga*, a monumental achievement of Government and industry, accomplished within the current procurement system that we are here to talk about. This highly capable cruiser embodies the most advanced technology in weapons systems today.

Further, this ship was delivered within budget and ahead of original schedule with all weapons systems ready to fight when it went to sea, a first in modern naval history. This stands as a tribute to the cooperation between industry and the Navy. The Navy, under outstanding leadership, coordinated the efforts of three major prime contractors, along with other participating departments of the Government, to manage and deliver one of the most complex warships in modern history.

Let me for the record recognize the importance of this investigation. The major reason I am appearing before you today, Mr. Chairman, is that, A, the reputation of our good company, Litton Industries, has come under attack from several quarters. To date this attack has been most unjust and without benefit of a fair and partial review of the facts by individuals who understand the Government procurement process.

I know it is not the objective, intent or desire of this subcommittee or these hearings to place in question the reputation of Litton Industries or Ingalls Shipbuilding. You made that very clear, sir. Nevertheless, the environment surrounding these hearings leaves us no choice but to address and defend that reputation. The reputation is easily defended because of the facts, the outstanding performance and the honesty and integrity which our corporation and shipyard have conducted business with the U.S. Government.

We applaud your search for the truth, and we fully support that effort. At the same time, we support these hearings probing into the defense procurement contract practices, we cannot accept a practice wherein judgments about our company's integrity have been rendered and printed by the media prior to the hearings. We are convinced these public statements are erroneous, incomplete, and misleading and not based on credible sources or complete data.

Mr. Erb's presentation will give you the facts placed in proper context that will make possible an examination of this major procurement process by the subcommittee.

Litton Industries is a manufacturing company. We were founded and are currently dedicated to discovery and development of advanced technology for incorporation in our products and our services. We demand the highest quality and productivity in our performance and I emphasize the demand for productivity because it has been an issue in the things we have been talking about here today.

We demand equally high capability in the products and services which we offer in the marketplace. We also stand behind the required warranty, maintenance, and support of our products.

Furthermore, Litton is an operating company. We have had in place for a number of years a system of management cost controls which assure a record of highest containment. We also have in place a rigorous system of checks and balances to maintain the operation and integrity of that system. In addition to the audit function inherent to the management information system which comes with it by which we control the corporation, we have a separately established audit group at the corporate level. This group of 42 internal auditors reports to the chief financial officer of the corporation outside of the operating organization to eliminate conflicts of interest in tracking and verifying our performance. This highly skilled internal audit group is comprised of CPA's and works with our public accounting firm on a rotating basis through all of our businesses to avoid duplication and save costs.

In the case of the shipyard, which is the case in point here, because of the magnitude of the cost there, we have obtained Touche Ross to audit Ingalls twice a year. That audit is in addition to Ingalls' internal audit function and that of the DCAA which is onsite. The results of this audit receive intensive review at the corporate level by the corporate controller, the chief financial officer, the president and myself.

The Litton board of directors has 3 inside directors, 13 directors plus 2 advisory directors. Those three are myself, our president, Mr. Hoch, and Mr. Joe Casey, chief financial officer of the corporation. The board has an audit subcommittee made up of outside directors all qualified by senior business experience. The audit subcommittee meets regularly with our internal auditors, our public accounting auditors and our management as required to satisfy themselves as to our methods, procedures and reporting.

These practices are standard and have been in place, tested and effective for many years. These operating procedures include my detailed participation as chief executive officer and extend throughout the whole of our company.

Our system and policies are designed to prevent errors, discover any that are committed and to afford restitution. The company policy is clear to all on this procedure, and it is rigidly enforced. No system can be totally foolproof or protect against certain individuals who choose to deliberately violate policy. We exercise considerable diligence to provide detection of any failure at an early time. The system must be dynamic to meet changing conditions and eliminate weaknesses. Experience shows our system and our capabilities have repeatedly demonstrated this capability.

Mr. Chairman, Litton has set the highest of standards for the quality of products and services we provide to our markets. Our policies require fairness and integrity in our dealings with all of our customers. Unfortunately, systems and people have shortcomings. To infer these shortcomings represent the policy of the company or its management is unacceptable. This is even more aggravated by the judgment before the hearing. This image of our company has been challenged. This is particularly true for our 11,000 employees in the shipyard, the 70,000 employees of Litton Industries. When the facts of these hearings are put in proper order and context, I am certain that challenge will prove unjustified.

Mr. Chairman, we are here to set the record straight and set aside your concerns.

The next part of our presentation will be Mr. Erb. We have a presentation, Mr. Chairman, to put things in perspective. In order to do that, what we have chosen to do is select Ingalls as a model, a model which is a highly successful, competent shipyard. They are building ships of the highest quality, ahead of schedule, on budget with tight controls and excellent learning-curve performance. This includes and is based on the good working relationship they have developed with the Navy and several Government agencies.

I don't have to remind you of this subcommittee, only a few short years ago, the shipbuilding industry was in total chaos. We were sitting in these kinds of hearings arguing about multimillion-dollar claims, stopwork orders, court activities, and open communication was literally impossible between us. That was fixed by the settlement of the claims and by installation of procurement practices that are now in place and they are working.

We have problems—of course we do. Mr. Erb's presentation is going to put those in context for you and the subcommittee so you may use them in your investigation and your determinations. Thank you very much.

Chairman Roth. Thank you. Mr. Erb, would you please proceed.

Mr. ERB. Mr. Chairman, my name is Len Erb. I have been employed by Litton Industries for 19 years, and I am currently a senior vice president of Litton Industries and responsible for Litton's marine group activities. In that capacity, I also serve as president of Litton's Ingalls Shipbuilding Division, a position I have held since 1975. I am assigned full time at Ingalls Shipbuilding located in Pascagoula, Miss., and I am thoroughly familiar with the policies of the company and the procedures under which we operate our shipyard.

[At this point, Senator Percy withdrew from the hearing room.]

Mr. ERB. I have with me today Mr. Jerry St. Pe', to Mr. O'Green's right. He is vice president of public and industrial relations, whose responsibility includes matters associated with our internal investigation programs, and Ed Robbins on my left, vice president of administration, whose responsibility includes contracts administration, financial accounting, and internal audits. Mr. St. Pe' has been an employee for 18 years, and Mr. Robbins for 16 years.

In your letter of April 21, 1983, you invited us to appear before the subcommittee. You asked that we address several topics. Before I address those topics, I wish to make a few general comments for the record.

Ingalls Shipbuilding has been building Navy ships in Pascagoula since 1938. The company's east bank facility produced troopships in World War II, as well as escort aircraft carriers, submarine tenders, and let layers. After the war, Ingalls produced amphibious assault ships, Forrest Sherman class destroyers, and beginning in the late 1950's, nuclear-powered attack submarines.

[At this point, Senator Roth withdrew from the hearing room.]

Mr. ERB. In the past 15 years, Litton has invested more than $350 million in building and modernizing its shipbuilding facilities in Pascagoula.

In the late 1960's, Litton Industries and the State of Mississippi, at the urging of the Navy, joined together to build an entirely new modern shipyard—the only shipyard that has been built since the end of World War II.

The shipyard was built on a new concept, which Ingalls pioneered in the 1970's, that of modular construction. This system has since been applied to the construction of *Spruance* class destroyers, LHA amphibious assault ships, *Kidd* class guided missile destroyers and is currently being applied to the construction of the *Ticonderoga* class Aegis missile cruisers.

The photo, chart 1, this technology has proven itself and has provided the Navy with the world's most capable facility for the construction of destroyers, cruisers, and amphibious ships.

Since mid-1975, Ingalls Shipbuilding has delivered 41 sophisticated new warships to the Navy, and they are operating in the fleets around the world, as is shown on the chart to my right, chart 2.

The 30 ships of the original *Spruance* class destroyer contract and five LHA amphibious assault ships were all delivered within a 5-year period between 1975 and 1980, establishing peacetime production records. In 1981 and 1982, the four *Kidd* class guided missile destroyers were delivered to the Navy by Ingalls on schedule and under budget. And thus far in 1983, Ingalls has delivered the 31st *Spruance* class destroyer, U.S.S. *Hayler* and U.S.S. *Ticonderoga*, the first Aegis cruiser.

Other important work at Ingalls has included the regular overhaul of the Navy's *Spruance* class destroyer fleet. No other shipyard in the country has matched the record of Ingalls' quality and schedule in overhauling *Spruance* destroyers. Since 1981, we have completed overhauls on three ships, all redelivered ahead of schedule despite significant growth and work that emerged in the yard.

The performance of Ingalls, and our reputation with the Navy for quality work produced within budget and on, or ahead of, schedule was one of the primary reasons Ingalls was competitively selected by the Navy in mid-1982 to modernize and reactivate the battleship *Iowa*. This ship, which has been under our jurisdiction since October, will be reactivated in June 1984, 6 months ahead of the schedule originally planned by the Navy.

We were asked to summarize the company's performance, and I am now addressing the four subjects we were asked to talk about. We were asked to summarize the company's performance in constructing *Ticonderoga*. Perhaps the greatest benefit to the Navy and the Nation is occurring at Ingalls in the CG-47 Aegis class cruiser program. As the first ship built specifically to protect our aircraft carrier battle forces from the threat of attacking missiles, these ships are among the most important elements of a new 600-ship Navy. They are the most capable ships in the world as it pertains to antisubmarine and antiair warfare, and probably a decade ahead in the field.

In September 1978, following competitive bidding, Ingalls was selected as lead shipbuilder for the CG-47 program. In addition to *Ticonderoga*, Ingalls has been awarded contracts for five other cruisers, and is procuring long lead material in preparation for the construction of three more ships which were funded by Congress in fiscal year 1983. We are also under a contract to assist in bringing another shipyard on line for production and competition with ourselves of these important ships.

[At this point, Senator Roth entered the hearing room.]

Mr. ERB. *Ticonderoga*, despite being the first of a new class, and incorporating a totally new weapon system technology, and despite more than 2,000 changes incorporated into the ship, was delivered this past December, 6 weeks ahead of the schedule that was established 4 years ago at contract award. And she was delivered not only within budget, but at a lower cost than the first of the *Spruance* destroyers, its root ship, and a far simpler and less capable ship.

The commissioning of *Ticonderoga* in January of this year, ahead of schedule, was not the first major success story in the construction of the Aegis cruisers. In August of last year, that ship became the first in recent naval history to successfully test fire all major weapons prior to commissioning. Normally, extensive test firing occurs after the ship joins the Navy fleet.

During those trials, 11 test missiles and Phalanx and deck gun ammunition were successfully fired. The high point of the sea trial, though, was the successful tracking and intercept of a drone target simulating an attack. We fired two live missiles at two separate targets and both scored hits. This is with a ship manned by a mixture of

Ingalls' employees, the ultimate new crew for the *Ticonderoga* and other Navy, civilian, and military personnel. It was a combination of those people that accomplished this feat.

Because of this and our accommodation of new technology when it was available, the ship will be battle ready for deployment at least 6 months earlier than 963, and 5 months earlier than 993. Certainly I don't have to tell you that early availability of a billion-dollar investment is significant.

We have done well in building and delivering *Ticonderoga*. But Ingalls is a company that is not satisfied with yesterday's performance. Our management and our employees understand and support the need for a strong Navy. We understand the need not only to build ships well, but to build them efficiently. We are conscious of the need to continually improve our performance for the benefit of the Navy and the Nation.

While we performed well on *Ticonderoga*, we are performing even better in building the second ship of the class, *Yorktown*, which was launched at the shipyard in January and christened on April 16. Here are a few examples of our improved performance:

When we launched *Ticonderoga* in April 1981, she was 52 percent complete. We launched *Yorktown* at 59 percent complete, a 15-percent improvement rate. Today, *Yorktown* is 70 percent complete. The period of time required from cutting the first steel to putting the ship in the water was reduced from 92 weeks to 80 weeks.

And the list goes on. Major equipment has all been installed earlier than was the case in *Ticonderoga*. Probably of most significance, we will commence testing the Aegis weapons system 12 weeks earlier than we did with *Ticonderoga*.

In spite of those accomplishments, perhaps the most significant measurement, and the one you are interested in, is the number of manhours to achieve building that ship. That figure has been significantly reduced in going from *Ticonderoga* to *Yorktown*.

These accomplishments were possible because the Navy and Ingalls are devoting their full efforts to building a better ship instead of preparing for court battles. Selection of an appropriate form of contract contributed significantly to this achievement.

I was asked to address the subject of Ingalls' experience with Navy procurement practices. As you are aware, Navy shipbuilding during the early 1970's saw the Government and its major shipbuilders engaged in the processing of claims and in expensive litigation.

Both the LHA contract awarded in May 1969 and the Spruance destroyer program awarded in June 1970 were total package procurements requiring the design, development, and production of ships to be awarded on a multiyear basis. The contracts were fixed-price incentive.

The total package procurement concept implemented with a fixed-price incentive type contract was an absolute failure for many reasons. Among the most important reasons was that it didn't provide for proper sharing of the risks involved in the design and construction of a complex new warship. It also required the Navy to operate in a totally unfamiliar hands-off mode in its management relationship with the contractor. Even if the Navy could have accommodated to that mode of operation, it is not appropriate for complex warship construction because it can result in a nearly outmoded ship at time of delivery. Court battles resulted and claims preparation costs in the millions, and distraction of senior management followed.

The Navy not only discarded the total package procurement contract, but in the mid-1970's, it changed from fixed-price type contract to cost reimbursement contract for the first ship of a class. As a consequence, Ingalls was awarded the four-ship DDG 993 contract on a cost-plus incentive fee basis.

The cost plus incentive fee contract does provide for proper sharing of risks and gives the Navy the flexibility to make the changes needed to assure an effective warship at delivery. The incentive feature rewards the contractor for good cost performance and, in fact, on that program, Ingalls under-ran target costs by tens of millions of dollars.

The Navy desired to not only incentivize cost but also its evaluation of quality, technical, and management performances. Therefore, in 1978, the Aegis cruiser contract was awarded to Ingalls competitively on a cost plus award fee basis. This is the best contractual vehicle currently in use for complex warship design and construction and produced the results I have already described for *Ticonderoga.*

There are pressures, including pressure from Congress, to move away from cost plus award fee back toward fixed-price contracts. Some of that is appropriate where there is stability in design. But complex warships in the Navy shipbuilding program probably never will have sufficient stability of design to be appropriate for that type of contractual vehicle.

I fear movement toward fixed price is too rapid. It has never been proven to me that a fixed price will always, or even most of the time, produce the lowest cost product. It is a copout for inadequate management skill.

My recommendation is to carefully examine the risks and the needs of the particular program in selecting the contract type and don't fall victim to the "fixed price is a virtue to itself" syndrome.

You also requested that I speak to the subject of our company's policies and practices regarding cost data on contracts. Ingalls Shipbuilding Division's time-charging policy is now, and always has been, that all employees charge their time to the job on which they work—absolute and without deviation.

Accurate and timely labor time charging is vital to the very existence of any company, including Ingalls. Actual labor costs recorded through time charging are used to bill Ingalls' customers for work performed, to manage the work being performed, and to provide historical costs which serve as a basis for our estimates for new business. In other words, accurate and timely labor time charging is essential from a customer's point of view so that he knows he receives value for which he pays and from management's point of view so that the present work can be managed and new work can be obtained.

We have four policies and five standard procedures and 15 departmental operating instructions which set forth in detail the way in which time is to be charged and the penalty for falsifying time charges. Copies of those policies and procedures have been provided to the investigative staff, and I request it be made a part of the record.

Chairman ROTH. Without objection.

[The material referred to was marked "Exhibit No. 4," for reference, and follows:]

EXHIBIT NO. 4

Litton **INGALLS SHIPBUILDING**

POLICY

SUBJECT Preparation and Approval of Employee Time Cards	EFFECTIVE DATE OCT 29 1976	NUMBER 3090.00	REV D
	PRIMARY RESP. CODE Y	AUDIT RESP. CODE Y	PAGE 1 OF 1
	SUPERSEDES 3090.00C	RESP. ORGANIZATION Finance	APPROVED BY L. Erb

A. All Ingalls salaried and hourly employees shall sign their time cards as a prerequisite for receiving their paychecks.

B. All Ingalls salaried and hourly employees shall attest to the accuracy of the total hours worked (Exclude unpaid overtime worked by salaried exempt employees) by affixing their signatures on the time cards. Signatures at a minimum shall include the employee's first initial and full last name.

C. Immediate supervisors at each level of management are responsible for countersigning and entering their badge number on the time cards of all employees reporting to them. The supervisor's signature will attest to the correctness of all entries and will certify the employee's signature. If the immediate supervisor is not available to sign an employee's time card, a supervisor who is familiar with employee's activities or the next higher level of supervision shall perform this function.

D. The following time card related rules are to be strictly adhered to by all employees:

   1. Employees shall not remove another individual's time card from time card racks.

   2. Employees shall not punch in or punch out any time card other than their own.

   3. Entries made to time cards including signatures, punch in/out times, and recorded hours worked must be legible and not be falsified or altered by any employee including members of supervision.

E. Any violations to these rules will be considered grounds for immediate dismissal of all parties involved.

SPCN #C-1, Dated: 9/2/80

Litton INGALLS SHIPBUILDING

STANDARD PROCEDURES

SUBJECT Employee Time Cards, Preparation of	EFFECTIVE DATE OCT 1 8 1979	NUMBER 3090.10		REV C
	PRIMARY RESP. CODE F	AUDIT RESP. CODE F	PAGE 1	OF 3
	SUPERSEDES 3090.10B (12-01-76)	RESP. ORGANIZATION Finance	APPROVED BY F. J. Frederic, Jr	

1.0 PURPOSE:

To provide instructions for the use and preparation of employee time cards.

2.0 ORGANIZATIONS AFFECTED:

All Organizations

3.0 REFERENCES:

Policy 3090.00	Preparation and Approval of Employee Time Cards

4.0 FORMS REQUIRED:

4.1	Form CR-321	Hourly and Salary Non-Exempt Time Card
4.2	Form CR-322	Exempt Direct Time Card
4.3	Form CR-449	Exempt Weekly - Indirect Time Card
4.4	Form CR-466	Select Weekly - Indirect Time Card

5.0 GENERAL:

5.1 Four types of time cards are used by the Company:

5.1.1 Hourly and Salaried Non-Exempt Time Card (Buff Card, 4.1), prepared daily for all hourly and salaried non-exempt employees except non-exempt indirect members of the President's Staff.

5.1.2 Select Weekly Indirect Time Card (Orange 4.4), prepared weekly by non-exempt indirect members of the President's Staff.

5.1.3 Exempt Direct Time Card (Green, 4.2), prepared weekly by exempt direct employees.

5.1.4 Exempt Indirect Time Card (Blue, 4.3), prepared weekly by exempt indirect employees.

| Denotes Change

SPCN #C-1
DATE: 09/02/80

6.0 **PROCEDURE:**

6.1 All salaried and hourly employees are required to sign time cards as a condition of their employment and as a prerequisite for receiving their paychecks (3.0).

6.2 All manual entries on time cards shall be made by using a black ball-point pen. Use of any other color ink or type of pen is prohibited. Corrections shall be made by drawing a single line through error and placing corrected entry above or to the side of the error. Employee's supervisor shall initial all corrections.

6.3 Each employee shall attest and certify to the accuracy of the total hours worked (exclude unpaid overtime worked by salaried exempt employees) as entered by his/her immediate supervisor by affixing his/her signature on the time card. The immediate supervisor at each level of management shall attest and certify to the accuracy of all entries on the employee's time card by affixing his/her signature and badge number on the time card. If the immediate supervisor is not available to sign an employee's time card, a supervisor who is familiar with employee's activities or the next higher level of supervision shall perform this function.

6.4 Violation of any of the following time card rules will be considered grounds for immediate dismissal of all parties involved.

6.4.1 Employees shall not remove another individual's time card from the time card rack.

6.4.2 Employees shall not punch in or punch out any time card other than their own.

6.4.3 Entries made to time cards including signatures, punch in/out times, and recorded hours worked must not be falsified or altered by any employee including members of supervision.

6.5 Hourly and Salaried Non-Exempt employees are compensated on the basis of one tenth of an hour for each full tenth of an hour worked. A work hour is divided into ten (10) consecutive six (6) minute periods beginning with the start time of an employee's shift.

INGALLS SHIPBUILDING

NUMBER	REV	PAGE	OF
3090.10	C	3	3

6.5.1 The tenths of an hour for which employees are paid or docked shall be calculated as follows:

0	minutes	.0	hour
1-6	"	.1	"
7-12	"	.2	"
13-18	"	.3	"
19-24	"	.4	"
25-30	"	.5	"
31-36	"	.6	"
37-42	"	.7	"
43-48	"	.8	"
49-54	"	.9	"
55-60	"	1.0	"

DIVISION STAFF CONCURRENCE		
Management Systems Engineering		

Litton **INGALLS SHIPBUILDING**

POLICY

SUBJECT Certification of Records	EFFECTIVE DATE NOV 27 1979		NUMBER 1020.10		REV C
	PRIMARY RESP. CODE F	AUDIT RESP. CODE F	PAGE 1 OF 1		
	SUPERSEDES 1020.10B (03-14-77)	RESP. ORGANIZATION Finance	APPROVED BY L. Erb		

A. Ingalls Shipbuilding supervisory management at all levels of organization shall ensure that certification signatures are affixed to all work records attesting that the work performance recorded has been actually completed and in accordance with company, customer and regulatory agency requirements. All organizations shall take appropriate action to maintain a climate of personal integrity in regard to certification of records through audit assignment of qualified personnel and elimination of improper practices.

B. All signatures for record attesting conditions or actions shall be based upon personal observation, certified records on file, direct report from watchstanders or objective evidence. All certification records shall clearly indicate the items and attributes certified, the signature of the individual making the certification and the date of the certification. No one shall certify a record based upon "hearsay" or "probable occurrence" without full written disclosure of the basis of the record and approval by all appropriate authority. In no case shall "urgent need" be allowed to influence the making or acceptance of a record. The penalty for falsification of records will be discharge.

C. Compliance with this policy shall be self-audited by each department. Company audit agencies shall audit personnel compliance with this policy.

Litton INGALLS SHIPBUILDING

STANDARD PROCEDURES

SUBJECT Correction of Labor Rejects	EFFECTIVE DATE SEP 10 1981	NUMBER 3030.62		REV C
	PRIMARY RESP. CODE F	AUDIT RESP. CODE F	PAGE 1 OF 6	
	SUPERSEDES 3030.62B (05-20-77)	RESP. ORGANIZATION Finance	APPROVED BY F. J. Frederic,Jr	

1.0 PURPOSE:

To outline the system for the correction of direct and indirect time card validation rejects.

2.0 ORGANIZATIONS AFFECTED:

2.1 Operations
2.2 Administration
2.2.1 Finance
2.3 Programs Management
2.4 Materiel

3.0 FORMS REQUIRED:

3.1	Form F-285	In Process Shops/Outfitting Control Groups Status
3.2	Form F-298	CP&A Vessel (Hard Task) Labor Authorization/Change
3.3	Form R-3773	MWP Task Performance Plan

4.0 GENERAL:

4.1 The Consolidated Company Planning and Audit (CP&A) file is a computer medium containing all Ingalls accounting systems, Group Index Plan, and Group Level Budgets and is used as an audit file to determine that charges of costs are as authorized.

4.2 The Group Index is the detail production plan by which ships are built. Group Level Budgets are used to measure the use of resources in performing the detailed production plan.

4.3 All time card charges are validated (matched) against the CP&A file. Charges which are not authorized in the CP&A file are rejected until either the charge data is corrected or, if required, the CP&A file is amended to authorize the charge.

4.4 The correction of labor rejects is the joint responsibility of Finance, Programs Management, and Operations. Materiel is responsible for all time charge rejects affecting Transportation Work Authorizations.

THIS IS A MAJOR REVISION, THEREFORE CHANGES ARE NOT INDICATED.

4.5 Vessel (Hard Task) Labor Authorizations are established on the CP&A file by Operations (Prod. Plng. & Control and Industrial Engineering) for surface ships. The authorization structure is as follows:

HULL	ACCOUNT	BERTH	WORK STATION	COST CENTER	OPERATIONS CODE
XXXX	XXXX	XXXX	XXX	XXX	XX
Established by Production Planning & Control				Established by I.E.	

4.6 All corrections are made in red immediately above the line being corrected and written neatly and legibly.

4.7 Program (Soft Task) Labor Authorizations are established on the CP&A file by Finance (Program Finance). The authorization structure is as follows:

MWP	COST CENTER	OPERATIONS CODE
XXXX XXXX XXXX	XXX	XX

4.8 Overhead (Indirect) and Miscellaneous Work Order Authorizations are established on the CP&A by Finance (Budgets). These authorization structures are as follows:

Overhead (Indirect):	OVERHEAD ACCOUNT XXXX	COST CENTER XXX
Miscellaneous Work Order:	MWP WORK ORDER XXXX XXXX XXXX	COST CENTER XXX

5.0 PROCEDURE:

5.1 Master Planning & Industrial Engineering (Vessel Labor Rejects):

5.1.1 Industrial Engineering (I.E.) shall correct the following vessel labor rejects:

5.1.1.1 Reject Codes 609 and 615.

a. Verify the validity of the time charges. If valid, establish the cost center and applicable operations code on the CP&A file using Vessel Labor CP&A Authorization, Form F-298 (3.2) Appendix 2 (ref.). If the time charge is invalid make the necessary corrections on Report X483-09R1 (Appendix 4) for the following:

1. Reject Code 609, "No Cost Center on CP&A File for this Hull, Account, Berth, and Work Station."

2. Reject Code 615, "No Match Cost Center on CP&A File for this Hull, Account, Berth, and Work Station."

5.1.1.2 Reject Code 610, "No Match Work Station - No Work Station Present on the CP&A for the Hull, Account and Berth."

a. If the Hull, Account, and Berth are valid, Production Control shall be requested to establish the necessary data on the CP&A file.

b. If the Hull, Account, and Berth are invalid, the correct charge shall be determined and the appropriate correction shall be made on Report X483-09R1 (Appendix 4).

5.1.1.3 Reject Code 612, "No Match Hull, Account, and Berth on the CP&A file for the Hull, Account, and Berth."

a. Verify the validity of the time charge. If valid, coordinate with Production Planning and Control to establish the hull, account, berth, and work station on the CP&A file. Once the hull, account, berth, and work station are established, I.E. shall establish the applicable cost centers and operations code on the CP&A File using the Vessel Labor CP&A Authorization Form F-298 (3.2) (Appendix 4). If the time charge is invalid, I.E., with the assistance of Operations, shall make the necessary corrections on Report X483-09R1 (Appendix 4).

5.1.1.4 Reject Code 616, "No Match Operations Code on the CP&A for this Operation."

a. Verify the validity of the time charge. If valid, establish the Operations Code on the CP&A file using the Vessel Labor CP&A Authorization, Form F-298 (3.2) (Appendix 4). If the time charge is invalid, I.E., with the assistance of Operations, shall make the necessary corrections on Report X483-09R1 (Appendix 4).

5.1.1.5 Reject Codes 623 and 624.

a. I.E., with the assistance of Operations, shall verify the cost center performing the work and make the necessary corrections on Report X483-11R1 to the following: (Appendix 5)

1. Reject Code 623, "Charge to an Inactive Operations Code - Operations Code to be deleted from the CP&A for this Hull, Account, Berth, Work Station, and Cost Center."

2. Reject Code 624, "Charged to an Inactive Cost Center - Cost Center to be deleted from the CP&A File for this Hull, Account Berth, and Work Station."

5.2 Operations (Plant Engineering)

Shall be responsible for correction of all time charge rejects affecting Capital and Maintenance and verification of the rejected charges. If valid, coordinate with Finance (Cost Accounting) to have authorization established on the CP&A File. If invalid, make the necessary corrections on Report X483-11R1 (Appendix 5), and in case of Direct Time Charge Reject, forward to Industrial Engineering via Cost Accounting.

5.2.1 Production Control shall be responsible for correcting:

5.2.1.1 Reject Codes 613, 614, and 630 (Appendix 3)

a. Production Control checks their records, coordinates with crafts as required and either marks up the reject sheets indicating the corrections or forwards written requests to PP&C for schedule changes, requests to re-open bills or work station transfer requests for the following:

1. Reject Code 613, "Invalid Labor Charge - Group Closed."

2. Reject Code 614, "No Match Work Station, Work Station Charged Does Not Match the Work Station on the CP&A File."

3. Reject Code 630 "Actual Start Date Not on Consolidated Data Base."

5.2.2.2 Operations shall assist Industrial Engineering, Production Planning and Control and Finance as required to correct labor rejects.

5.3 Materiel (Transportation)

Shall be responsible for correction of all time charge rejects affecting Transportation Work Authorizations and verification of the rejected charges. If valid, coordinate with Finance (Cost Accounting) to have authorization established on the CP&A File. If invalid, make necessary correction on Report X483-11R1 and in case of Direct Time Charge Rejects, forward to Industrial Engineering via Cost Accounting.

5.4 Finance

5.4.1 Budgets

5.4.1.1 Reject Codes 601 and 602 (Appendix 5)

a. Budgets shall monitor the system to determine that charges are automatically charged at effective prepaid dates for the following:

1. Reject Code 601, "Suspended Charge - Vacation."

2. Reject Code 602, "Suspended Charge - Non Vacation."

5.4.2 Cost Accounting

5.4.2.1 Shall evaluate and assign correct codes to the following: (Appendix 5)

a. Reject Code 603, "Invalid Source Code not 1X through 9X."

b. Reject Code 604, "Invalid Transaction Code - Not 10, 20, 40, or 50."

c. Reject Code 605, "Invalid B/CE Code - Not Numeric."

Reject Code 625, "Indirect Charging Direct" shall be audited and corrected accordingly.

Shall correct all indirect time charge rejects except those affecting Capital, Maintenance, and Transportation Work Authorization.

5.4.2.2 Reject Codes 606 and 611 (Appendix 5)

a. Shall audit and verify all zero type rejects and correct input accordingly to the following:

1. Reject Code 606, "Hours and Dollars equal Zero."
2. Reject Code 611, "Type/Source 22-09 assigned Labor or Material Accounts Equal Zero or Blank."

5.4.2.3 Reject Code 607, "Transaction not valid Calendar Date (Appendix 5).

Shall audit transactions and make proper corrections.

5.4.2.4 Reject Codes 617 and 620 (Appendix 5)

a. Shall verify rejected data and correct the following accordingly:

1. Reject Code 617, "More than one 6B Record on the CP&A File."
2. Reject Code 620, "Invalid Record Type - Not 25, 26, 45, or 52."

5.4.2.5 Reject Code 619, "No Match GLA Type/Source 30-09" and all GLA rejects. shall be verified and assigned the proper General Ledger Account Number.

5.4.2.6 Reject Charge 626, "Direct Charging to Indirect" shall be audited and corrected accordingly.

5.4.2.7 Reject Codes 621 and 622, (Appendix 5)

a. Cost Accounting shall research and correct any rejects of this type.

1. Reject Code 621, "Charge to closed cost center - "C" in status code on C/C org. file. Edit performed in cost reformat.
2. Reject Code 622, "Charge to cost center not on C/C org. file. Edit performed in cost reformat."
3. Reject Code 627, "Invalid BACE - Not on Bluebook Table 12."

5.5 Programs Management (Program Manager):

5.5.1 The respective Program Managers shall coordinate the correction of Direct Program Labor (MWP) Time Card Validation Rejects. Correction of Labor rejects must be accomplished by taking one of the following actions:

5.5.1.1 Correct the mischarged data on Report X483-11R1, "Validation Reject Report Payroll" (See Appendix 5).

5.5.1.2 Submit the Management Work Package (MWP) Task Performance Plan, Form R-3773 (3.2) to Cost Accounting for input into the CP&A file (Appendix 6).

6.0 APPENDICES:

6.1	Appendix 1	Cost Validation - Reject Codes
6.2	Appendix 2	Industrial Engineering Input Document, Form F-298 (3.1)
6.3	Appendix 3	Validation Reject Report - X483-07R1 (Surface)
6.4	Appendix 4	Validation Reject Report - X483-09R1
6.5	Appendix 5	Validation Reject Report - X483-11R1
6.6	Appendix 6	MWP Task Performance Plan, Form R-3773 (3.3)

DIVISION STAFF CONCURRENCE

MANAGEMENT SYSTEMS ENGINEERING		

INGALLS SHIPBUILDING

APPENDIX 1

NUMBER	REV	PAGE	OF
3030.62	C	1	2

COST VALIDATION - REJECT CODES

CODE	RESP. * SURFACE	EDIT SEQUENCE	REJECT REASON
601	B	7	Suspended Charge - Vacation
602	B	8	Suspended Charge - Non-Vacation
603	C/A	3	Invalid Source Code - Not 1X through 9X
604	C/A	5	Invalid Transaction Code - Not 10, 20, 40, or 50
605	C/A	9	Invalid BACE Code - Not Numeric
606	C/A	4	Hours and Dollars equal zero
607	C/A	6	Transaction Date not a valid Calendar Date
608	OP	20	Transaction Date more than 90 days prior to Schedule Start Date
609	I/E	18	No Cost Center on CP&A for this Hull, Account, Berth, and Work Station
610	I/E	15	No Match W/S - No W/S Present on CP&A
611	C/A	22	Type/Source 22-09, Assigned Labor or Material Account equal zeros or blank
612	I/E	13	No match Hull, Account, Berth
613	PP&C	16	Invalid labor charge - Group Closed, Status Code greater than 49
614	PP&C	14	No match Work Station
615	I/E	17	No match Cost Center
616	I/E	17	No match Operation
617	C/A	12	More than one "6B" record on the CP&A File
619	C/A	11	No match GLA, Type/Source 30-09

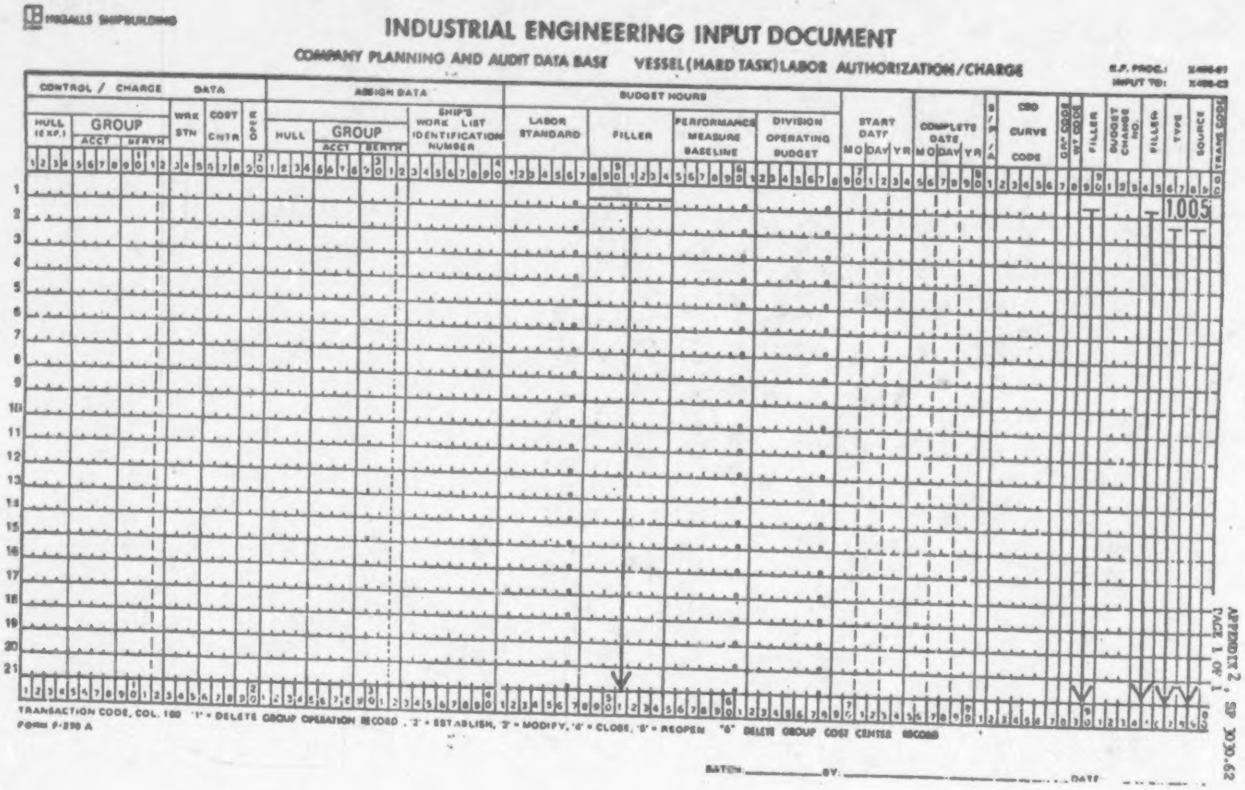
* Responsibility
C/A=Cost Accounting, OP=Operations, I/E=Industrial Engineering, B=Budgets
PP&C=Production Planning & Control

APPENDIX 1

INGALLS SHIPBUILDING

NUMBER	REV	PAGE	OF
3030.62	C	2	2

CODE	RESP. * SURFACE	SEQUENCE	REJECT REASON
620	C/A	10	Invalid Validation Record Type - Not 25, 26, 45, or 52
621	C/A	1	Charge to Closed Cost Center - "C" in Status Code on C/C Org. File. Edit performed in Cost Reformat
622	C/A	2	Charge to a cost center not on C/C Org. File Edit performed in Cost Reformat
623	I/E	23	Inactive Operation - Opration to be deleted from CP&A File
624	I/E	21	Inactive Cost Center - Cost Center to be deleted from CP&A File
625	C/A	24	Indirect Charging Direct
626	C/A	25	Direct Charging Indirect
627	C/A	26	Invalid BACE - Not on Blue Book BACE Table 12
628	IE	27	Inactive Group - Group Flagged for deletion
630	PP&C	20	Actual Start Date Not on CDB



INGALLS SHIPBUILDING

INDUSTRIAL ENGINEERING INPUT DOCUMENT

COMPANY PLANNING AND AUDIT DATA BASE   VESSEL (HARD TASK) LABOR AUTHORIZATION/CHARGE

E.P. PROC.: X400-01
INPUT TO: X400-C3

	CONTROL / CHARGE DATA						ASSIGN DATA				BUDGET HOURS																				
	HULL (EXP.)	GROUP ACCT	GROUP BERTH	WRK STN	COST CNTR	OPER	HULL	GROUP ACCT	GROUP BERTH	SHIP'S WORK LIST IDENTIFICATION NUMBER	LABOR STANDARD	FILLER	PERFORMANCE MEASURE BASELINE	DIVISION OPERATING BUDGET	START DATE MO	START DATE DAY	START DATE YR	COMPLETE DATE MO	COMPLETE DATE DAY	COMPLETE DATE YR	S/P/A	CSD CURVE CODE	GRP CODE	WT CODE	FILLER	BUDGET CHANGE NO.	FILLER	TYPE	SOURCE	TRANS CODE
1																														
2																												1005		
3																														
4																														
5																														
6																														
7																														
8																														
9																														
10																														
11																														
12																														
13																														
14																														
15																														
16																														
17																														
18																														
19																														
20																														
21																														

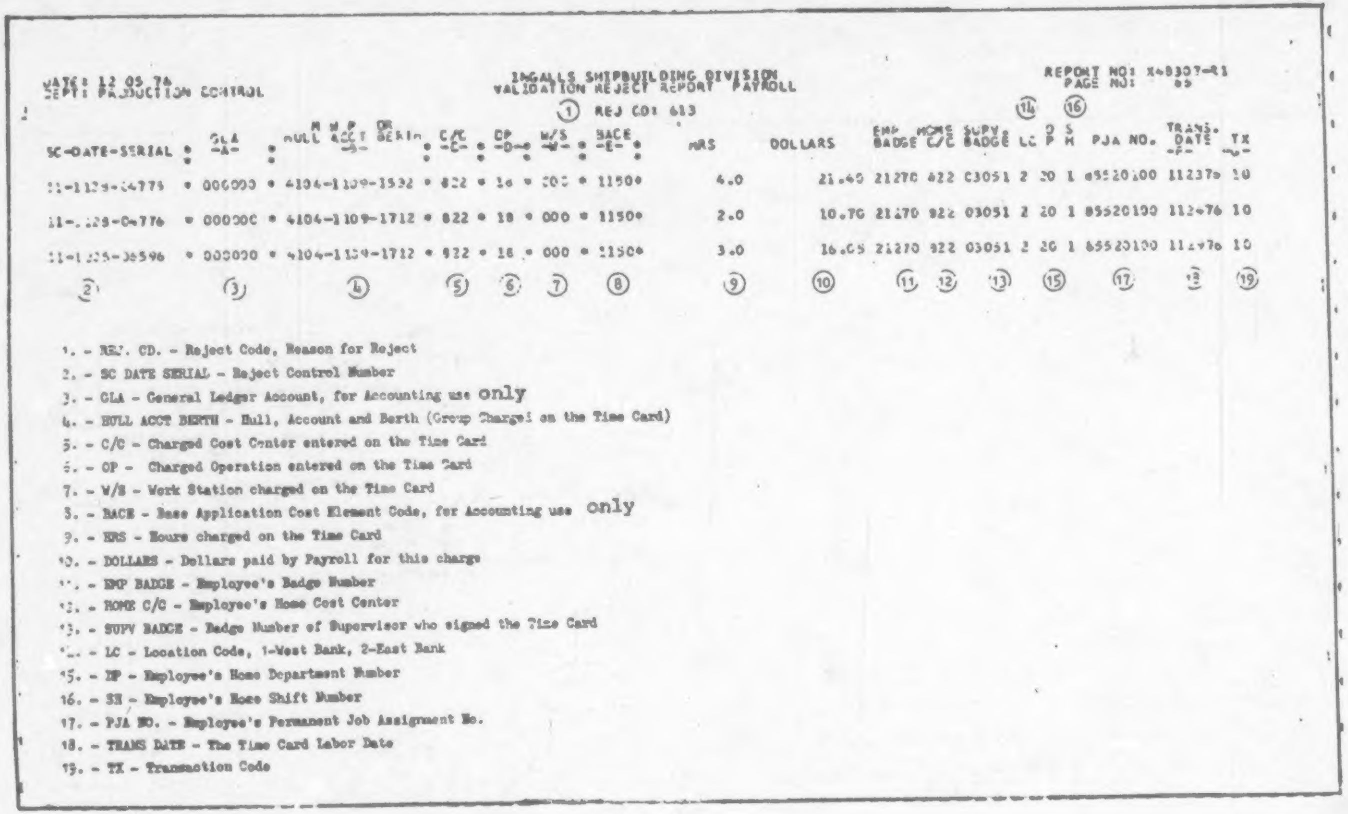
TRANSACTION CODE, COL. 180 '1' = DELETE GROUP OPERATION RECORD, '2' = ESTABLISH, '3' = MODIFY, '4' = CLOSE, '5' = REOPEN "6" DELETE GROUP COST CENTER RECORD

FORM P-290 A

BATCH ____________ BY: ____________________ DATE ____________

APPENDIX 2, SP 3030.62
PAGE 1 OF 1

APPENDIX 3
SP 3030.62, Page 1 of 1



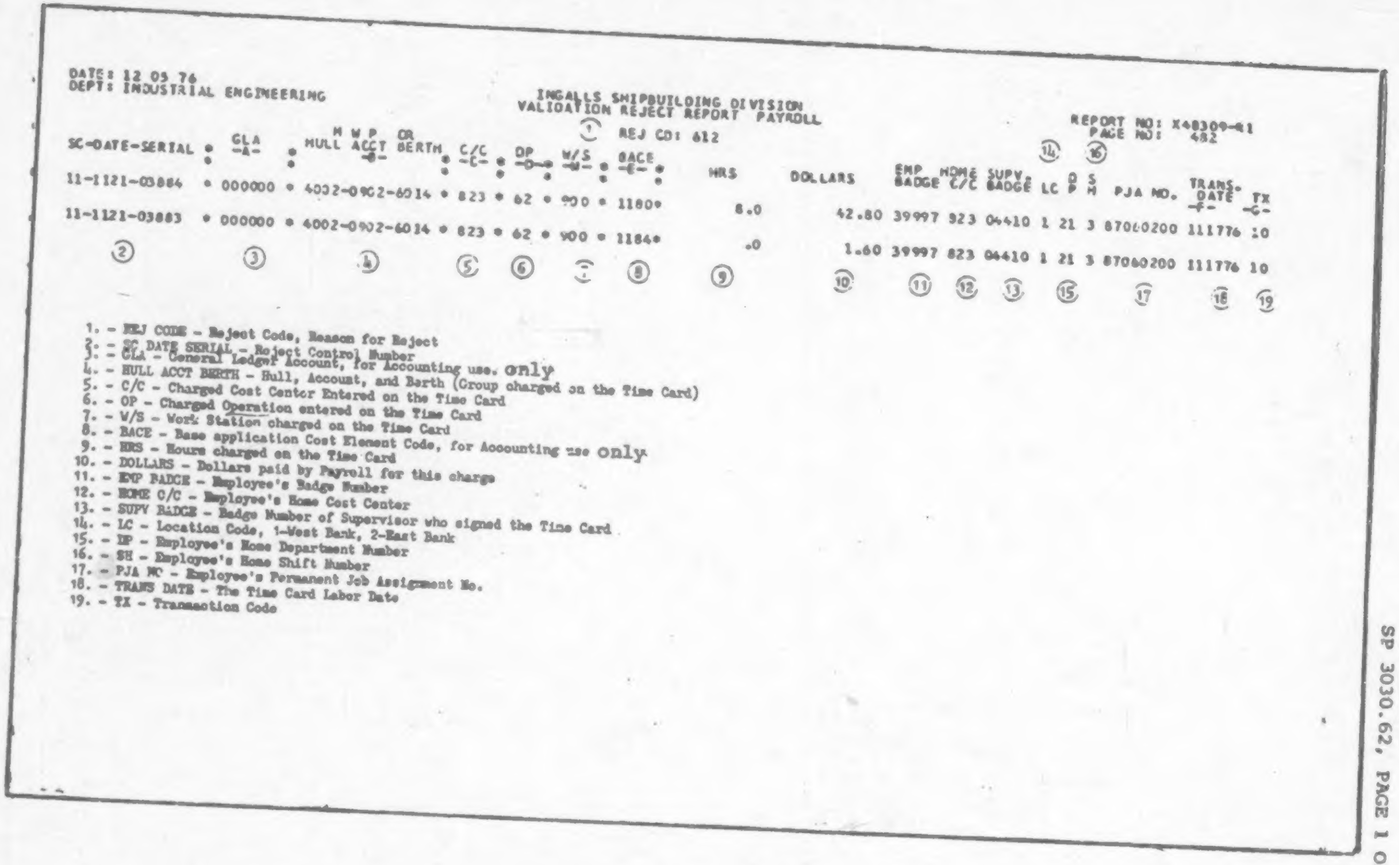
```
DATE: 12 05 76                         INGALLS SHIPBUILDING DIVISION                 REPORT NO: X-8307-R1
DEPT: PRODUCTION CONTROL             VALIDATION REJECT REPORT  PAYROLL                   PAGE NO:     85
                                            ① REJ CD: 613                            ⑭   ⑯
                          H W P   OR
                 GLA      HULL ACCT BERTH   C/C    OP    W/S    BACE                          EMP  HOME SUPV.     D S            TRANS.
SC-DATE-SERIAL : -A-    :      -B-        : -C- : -D- : -W- : -E- :    HRS      DOLLARS  BADGE C/C  BADGE  LC P M  PJA NO.   DATE   TX
                                                                                                                         -F-    -G-
11-1129-04775 • 000000 • 4104-1109-1532 • 822 • 16 • 000 • 1150•      4.0        21.40  21270 822  03051  2 20 1 85520100  112376  10

11-1129-04776 • 000000 • 4104-1109-1712 • 822 • 18 • 000 • 1150•      2.0        10.70  21270 822  03051  2 20 1 85520100  112476  10

11-1129-06596 • 000000 • 4104-1109-1712 • 822 • 18 • 000 • 1150•      3.0        16.05  21270 822  03051  2 20 1 85520100  112476  10
      ②           ③            ④            ⑤     ⑥     ⑦     ⑧          ⑨          ⑩       ⑪   ⑫    ⑬       ⑮       ⑰        ⑱     ⑲
```

1. - REJ. CD. - Reject Code, Reason for Reject
2. - SC DATE SERIAL - Reject Control Number
3. - GLA - General Ledger Account, for Accounting use only
4. - HULL ACCT BERTH - Hull, Account and Berth (Group Charged on the Time Card)
5. - C/C - Charged Cost Center entered on the Time Card
6. - OP - Charged Operation entered on the Time Card
7. - W/S - Work Station charged on the Time Card
8. - BACE - Base Application Cost Element Code, for Accounting use only
9. - HRS - Hours charged on the Time Card
10. - DOLLARS - Dollars paid by Payroll for this charge
11. - EMP BADGE - Employee's Badge Number
12. - HOME C/C - Employee's Home Cost Center
13. - SUPV BADGE - Badge Number of Supervisor who signed the Time Card
14. - LC - Location Code, 1-West Bank, 2-East Bank
15. - DP - Employee's Home Department Number
16. - SH - Employee's Home Shift Number
17. - PJA NO. - Employee's Permanent Job Assignment No.
18. - TRANS DATE - The Time Card Labor Date
19. - TX - Transaction Code

APPENDIX 4
SP 3030.62, PAGE 1 OF 1



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DATE: 12 03 76
DEPT: INDUSTRIAL ENGINEERING
                                                       INGALLS SHIPBUILDING DIVISION
                                                     VALIDATION REJECT REPORT  PAYROLL
                                                                                                  REPORT NO: X48309-41
                         H W P  OR                       ①  REJ CD: 612                             PAGE NO:   482
SC-DATE-SERIAL *  GLA  *  HULL ACCT BERTH   C/C    OP     W/S    BACE                                         ⑭   ⑯
               *  -A-  *        -B-       * -C-  * -D-- * -W- *  -E- *     HRS     DOLLARS     EMP   HOME SUPV.      D S          TRANS.
                                          *      *      *     *      *                          BADGE C/C  BADGE  LC P H  PJA NO.   DATE   TX
                                                                                                                                  -F-    -G-
11-1121-03884  * 000000 * 4002-0902-6014 * 823 * 62 * 900 * 1180*       8.0       42.80   39997 923  04410  1  21 3 87060200  111776  10

11-1121-03883  * 000000 * 4002-0902-6014 * 823 * 62 * 900 * 1184*        .0        1.60   39997 823  04410  1  21 3 87060200  111776  10

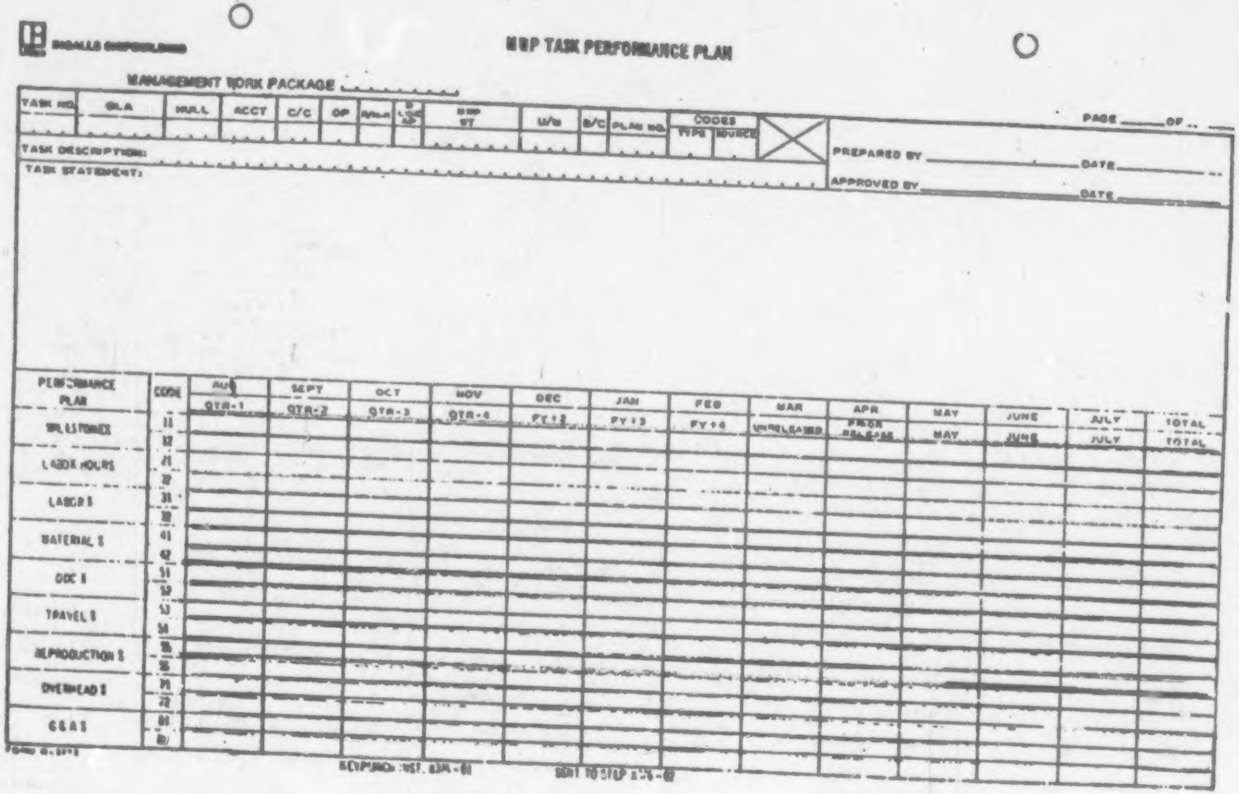
     ②              ③            ④           ⑤     ⑥     ⑦     ⑧          ⑨          ⑩       ⑪    ⑫    ⑬      ⑮      ⑰         ⑱     ⑲
```

1. - REJ CODE - Reject Code, Reason for Reject
2. - SC DATE SERIAL - Reject Control Number
3. - GLA - General Ledger Account, for Accounting use. only
4. - HULL ACCT BERTH - Hull, Account, and Berth (Group charged on the Time Card)
5. - C/C - Charged Cost Center Entered on the Time Card
6. - OP - Charged Operation entered on the Time Card
7. - W/S - Work Station charged on the Time Card
8. - BACE - Base application Cost Element Code, for Accounting use only
9. - HRS - Hours charged on the Time Card
10. - DOLLARS - Dollars paid by Payroll for this charge
11. - EMP BADGE - Employee's Badge Number
12. - HOME C/C - Employee's Home Cost Center
13. - SUPV BADGE - Badge Number of Supervisor who signed the Time Card
14. - LC - Location Code, 1-West Bank, 2-East Bank
15. - DP - Employee's Home Department Number
16. - SH - Employee's Home Shift Number
17. - PJA NO - Employee's Permanent Job Assignment No.
18. - TRANS DATE - The Time Card Labor Date
19. - TX - Transaction Code

```
DATE: 12 05 76                          INGALLS SHIPBUILDING DIVISION                          REPORT NO: X48311-R1
DEPT: COST ACCOUNTING                  VALIDATION REJECT REPORT  PAYROLL                         PAGE NO:   108
                                            ① REJ CD: 612                               ⑭ ⑯
                                 H W P  OR                                                                       D S             TRANS.
SC-DATE-SERIAL *  GLA   *  HULL ACCT BERTH * C/C * OP * W/S * BACE *   HRS     DOLLARS   EMP  HOME SUPV.  LC P H  PJA NO.   DATE   TX
               *  -A-   *      -B-       * -C- * -D-* -E- * -E- *                        BADGE C/C BADGE              -F-    -G-
11-1205-01129  * 000000 * 1212-1215-0021 * 519 * 00 * 000 * 1190*   3.0        8.78 10812 519 09481 2 72 1 41320805 120176 10
11-1205-01127  * 000000 * 1212-1215-0021 * 519 * 00 * 000 * 1190*   3.0        8.78 10812 519 02484 2 72 1 41320805 120276 10
11-1205-01130  * 000000 * 1212-1215-0021 * 519 * 00 * 000 * 1190*   3.0        8.78 10812 519 09451 2 72 1 41320805 113076 10
11-1205-01128  * 000000 * 1212-1215-0021 * 519 * 00 * 000 * 1190*   3.0        8.78 10812 519 03758 2 72 1 41320805 120376 10
11-1205-01126  * 000000 * 1212-1215-0021 * 519 * 00 * 000 * 1190*   3.0        8.78 10812 519 03953 2 72 1 41320805 112976 10
11-1205-01131  * 000000 * 1212-1215-0021 * 519 * 00 * 000 * 1192*   1.0        4.39 10812 519 02484 2 72 1 41320805 120276 10
    ②              ③            ④            ⑤     ⑥    ⑦     ⑧       ⑨          ⑩    ⑪   ⑫   ⑬      ⑮      ⑰       ⑱    ⑲
```

1. - REJ CD - Reject Code, Reason for Reject
2. - SC DATE SERIAL - Reject Control Number
3. - GLA - General Ledger Account, for Accounting use only
4. - HULL ACCT BERTH - Hull, Account, and Berth (Group charged on the Time Card)
5. - C/C - Charged Cost Center entered on the Time Card
6. - OP - Charged Operation entered on the Time Card
7. - W/S - Work Station charged on the Time Card
8. - BACE - Base application Cost Element Code, for Accounting use only
9. - HRS - Hour Charged on the Time Card
10. - DOLLARS - Dollars paid by Payroll for this charge
11. - EMP BADGE - Employee's Badge Number
12. - HOME C/C Employee's Home Cost Center
13. - SUPV BADGE - Badge Number of Supervisor who signed the Time Card
14. - LC - Location Code, 1-West Bank, 2-East Bank
15. - DP - Employee's Home Department Number
16. - SH - Employee's Home Shift Number
17. - PJA NO - Employee's Permanent Job Assignment No.
18. - TRANS DATE - The Time Card Labor Date
19. - TX - Transaction Code

APPENDIX 6
SP 3030.62
PAGE 1 OF 1



INGALLS SHIPBUILDING

MWP TASK PERFORMANCE PLAN

MANAGEMENT WORK PACKAGE ________

PAGE _____ OF ___

TASK NO.	GLA	HULL	ACCT	C/C	OP	[illegible]	[illegible]	MWP ST	U/M	B/C	PLAN NO.	CODES TYPE	 SOURCE

TASK DESCRIPTION:

TASK STATEMENT:

PREPARED BY ____________ DATE ________

APPROVED BY ____________ DATE ________

PERFORMANCE PLAN	CODE	AUG QTR-1	SEPT QTR-2	OCT QTR-3	NOV QTR-4	DEC FY+2	JAN FY+3	FEB FY+4	MAR UNRELEASED	APR PRIOR RELEASE	MAY MAY	JUNE JUNE	JULY JULY	TOTAL TOTAL
MILESTONES	11													
	12													
LABOR HOURS	21													
	22													
LABOR $	31													
	32													
MATERIAL $	41													
	42													
ODC $	51													
	52													
TRAVEL $	53													
	54													
REPRODUCTION $	55													
	56													
OVERHEAD $	71													
	72													
G&A $	81													
	82													

FORM [illegible]

[illegible]

[illegible]

Litton INGALLS SHIPBUILDING

STANDARD PROCEDURES

SUBJECT Time and Labor Charging Record (Direct Exempt Employees)	EFFECTIVE DATE MAR 1 3 1982	NUMBER 3090.11		REV New
	PRIMARY RESP. CODE F	AUDIT RESP. CODE F	PAGE 1 OF 2	
	SUPERSEDES	RESP. ORGANIZATION Finance	APPROVED BY F. J. Frederic, Jr.	

1.0 PURPOSE:

To describe the procedure for ensuring accurate time and labor charging for direct exempt employees.

2.0 ORGANIZATIONS AFFECTED:

All Organizations

3.0 REFERENCES:

3.1	Policy 3090.00	Preparation and Approval of Employee Time Cards
3.2	SP 3090.10	Employee Time Card, Preparation of
3.3	SP 3055.02	Internal Audit

4.0 FORMS REQUIRED:

4.1	Form R-262	Time and Labor Charging Record
4.2	Form CR-322	Exempt Direct Time Card

5.0 GENERAL:

Time cards are the source documents used to record time and labor distribution. It is essential that all time card entries be accurate and legible (3.0).

6.0 RESPONSIBILITIES:

6.1 Each direct exempt employee shall accurately record his/her time and ensure that time is charged to the proper charge numbers for the work performed.

6.2 Each supervisor/group leader shall ensure that time charging records for employees under their cognizance are maintained by those employees in accordance with this procedure and that each employee is aware of the correct charge numbers to use for work being performed.

SPCN: #NEW-2
DATE: 5/27/82

INGALLS Shipbuilding

NUMBER	REV	PAGE	OF
3090.11	New	2	2

7.0 PROCEDURE:

7.1 Time and Labor Charging Record

7.1.1 Supervisors/group leaders shall provide each employee with a copy of Form R-262, Time and Labor Charging Record (4.1) each Monday morning. Other alternate forms containing the same information as Form R-262 may be used if approved by Finance.

7.1.2 Each direct exempt employee shall fill in the Time and Labor Charging Record listing the Hull, Order, and Berth Number and Hours Worked for each task as the task is completed (See Appendix 1).

7.1.3 At the end of each week, employees shall attest to the accuracy of their time and labor charging record by signing the card.

7.1.4 All manual entries on the Time and Labor Charging Record (4.1) and the time card (4.2) shall be made by using a black ball point pen. Corrections shall be made by drawing a single line through the error and placing corrected entry above or to the side of the error for time cards. The Employee and his or her supervisor shall initial all corrections.

7.1.5 Each direct exempt employee shall be responsible to maintain his time and labor charging record on file for a period of six months.

7.1.6 If a direct exempt employee terminates, it shall be his supervisor's responsibility to obtain and maintain on file the employee's time and labor charging record for the required length of time.

7.2 Preparation and Approval of Time Cards

7.2.1 Utilizing the Time and Labor Charging Record (4.1), direct exempt employees shall make time card entries, sign and forward Time Card to his/her supervisor/group leader for review and approval.

7.2.2 The supervisor/group leader shall attest and certify to the accuracy of all entries on the employee's time card by affixing his/her signature and badge number on the time card. If the group leader is not available to sign time cards, a supervisor who is familiar with employee's task assignments or the next higher level of supervision shall perform this function.

8.0 APPENDIX:

Appendix 1 Direct Time and Labor Charging Record

| DENOTES CHANGE

DIVISION STAFF CONCURRENCE

MANAGEMENT SYSTEMS ENGINEERING		

FORM R-2178H

APPENDIX 1
SP 2080.11
PAGE 1 OF 1

TIME AND LABOR CHARGING RECORD

HULL	MWP ORDER NO.	BERTH	DAILY TIME RECORD							TOTAL HOURS
			MON.	TUES.	WED.	THUR.	FRI.	SAT.	SUN.	
Total Hours										

Form R-282

EMPLOYEE ____________________

DEPT/BADGE ____________________

WEEK ENDING ____________________

This is a true and complete statement of my hours for the total week.

____
Employees Signature

Mr. ERB. We also are not satisfied with merely issuing a policy and putting it in the files. We have a constant effort ongoing to make sure people are aware of those policies and have an opportunity to understand them.

In the interest of brevity, I will not go through the specific seven items this morning. They are in the record and you can see them.

Ingalls' policy with regard to time charging is clear. Employees' time is to be charged only to the contract on which that time has been spent. That is the written policy, and it's the policy to be followed and the one we enforce. Substantial publicity, as I already indicated, and education is conducted along those lines.

As a management, we have been aggressive in enforcing the policy. We conduct periodic audits to verify that the policy is being followed, and when it is not, we take corrective action. We administer discipline to those in our work force who, for whatever reason, violate the policy.

During the past 5 years, 165 employees received some form of discipline for time charging violation. Of that number, 66 were discharged. In operations the size of Ingalls Shipbuilding in which more than 20 million man-hours—20 million man-hours—are performed each year by 10,000 employees, assuring accurate time charging gets a lot of attention.

In addition to Ingalls' internal audits and DCAA checks, we have onsite military and civilian personnel, of which many are dedicated to monitoring and surveying the quality, cost, and schedule performance of our contracts.

Additional Government responsible people with the responsibility of reviewing us are based in Washington. But despite these efforts, some level of misassignment occurs. We don't condone or tolerate any level of improper charging of time, but one must strike a balance between absolute control and return on the investment made in monitoring and surveillance.

What we are acknowledging here today concerning misassignment of hours has already been properly reported to the appropriate Government agencies, the Navy, the Defense Contract Audit Agency, the FBI, and this subcommittee. And the record should properly reflect that it was Ingalls' internal investigation and audits, not those of outside agencies, that quantified the degree of misassignment.

While other reviews of matter have been undertaken by other agencies and organizations, we have been provided no information—none at all—which conflict with the result of our company's review and findings.

You are aware that "60 Minutes" and your investigators have tested our time-charging system. Chart 3, in support of the examination, we have conducted investigations and audits and we have verified and quantified a total of 18,000 hours misassigned from a work force that has averaged 18,000 employees over the past 6 years.

[At this point, Senator Percy entered the hearing room.]

Chairman ROTH. Senator Percy has asked for permission to ask several questions because he can't return at 3:30. We do have your material; if you want to give it fully on my return, I will be happy to hear it at that time. In the meantime, we will let Senator Percy ask any questions and then we will recess until 3:30.

Mr. O'Green. We will appreciate the time. I think you will find it very informative.

[At this point, Chairman Roth withdrew from the hearing room.]

Senator Percy [presiding]. Thank you very much, Mr. Chairman. If you would like to take time to summarize right now, I will be happy to have you put your entire statement in the record and then I have a couple of questions to ask Mr. O'Green.

Mr. Erb. Go ahead with the questions.

Senator Percy. First, I think you are entitled to know what conclusions some of us have come to as a result of this hearing. With respect to cross-charging, I think that was the part of it that most concerned me, having been so deeply involved a great part of my life in defense contracting. I have not seen any evidence presented today for the record that any top officials at Ingalls had any knowledge of the cross charging on commercial to Navy, or Navy to Navy, contracts while it was occurring. I would like, however, to ask both of you, Mr. Erb and Mr. O'Green, to your knowledge, and maybe it is repetitious to what you have answered already, but to your knowledge, did top management actually have any knowledge cross charging was occurring at the time it was occurring or at any time?

Mr. Erb. Absolutely not.

Mr. O'Green. After the fact, we were informed and corrective actions were taken.

Senator Percy. Fine. Thank you very much. I think that does help the record very much, indeed.

Mr. O'Green, I did mention this $256 gravity timer switch. I can understand when you have to provide a quick turnaround for a one-of-a-kind item, overhead costs can be relatively high. In this case, the markup was, it appeared to me, excessively high. Was this item a shelf item? What overhead charges could possibly justify 2,000-percent markup?

Mr. O'Green. Senator Percy, you missed my remark that people who don't have senior on hands long experience in shipbuilding are ill-equipped to make decisions and find out the facts. This is a super example.

That switch is bought under a system, devised by the Navy, to make procurement of things they need. They don't need to spend their time negotiating $10 and $12 items. Mr. Erb can give you the facts.

Mr. Erb. We operate, as has already been indicated, under basic ordering agreements. In fact, we have three separate basic order agreements. The concept is to separate out fixed charges and allocate those, irrespective of the cost of the item, and then allocate some of the peculiar costs that might go with that specific item.

I think the best way to look at it—we have a chart here that shows that since 1975, we have done $10 million worth of business under bolts, that switch, pumps, valves, you name it—a thousand different items—our total profit percentage for that effort is 11.3 percent. I don't get much credit from the chairman for making that level of profit.

Senator Percy. Is that before-tax profit?

Mr. Erb. That is correct. As a matter of fact, on almost a yearly basis, we sit down with the Navy, and we do a reconciliation of the activity that has taken place since our last reconciliation, and we determine whether those fixed factors that were assigned are proper and make adjustments. That has been going on since 1975.

At the bottom line, we haven't ripped off the Navy.

Senator Percy. But I have to say, there are a lot of industries today that would love to swap places with you—the automobile industry for one—11-percent profit. They are a long ways——

Mr. Erb. I am going to get out. I do not apologize for that 11.3-percent profit.

Senator Percy. I am not impressed with the overall profit figure. I think you have to look at specifics.

Mr. Erb. It would cost them four times as much to individually negotiate and process each one of them. This represents a savings for the Navy, not an extra cost, Senator.

Mr. O'Green. I would like to suggest, Senator Percy, that if we were to buy the switch as suggested—we can buy a switch for $13, $3, it is pretty simple-minded—but I would be in this investigating subcommittee tomorrow answering why I put a non-mil spec part into a ship that isn't going to work when it gets to sea and don't have anything to replace it. I think the process and understanding with respect to logistics and spares by those who give the evidence here is so little and so thin that it is just amazing.

Senator Percy. Still, this is a stock item.

Mr. O'Green. That doesn't have anything to do with it. We don't write the specifications on how the military is going to buy. We only follow them. As a matter of fact, Mr. Erb told me yesterday after we sent a letter to the Navy pointing out this system is going to come out to have unusual items just like you have and when they fall into hands when they want to use it wrongly, it will come out that way, and that is exactly what has come out.

Mr. Erb. That letter went into the record in 1977.

Mr. O'Green. We have it available. We will be pleased to submit it.

Senator Percy. I would like to get your own reactions to the habitability disclosures that were made on "60 Minutes." Purchases were mentioned of expensive furniture to equip new ships. The Navy paid $14,000 for a sectional sofa; $13,500 for a bookcase; $1,500 for a coffee-table; $1,000 for a telephone stand. What is your own reaction as to whether or not these items are really in keeping with the tight budget? It doesn't appear as though this is an opulence that is essential and necessary to the defense of the country. I assume the Navy is going to stop the practice. What is your own personal reaction?

Mr. Erb. If you are asking me if I were the captain of that ship, would I have done it, the answer is no, but I probably am not a good judge, as any of my staff will tell you; I'm a damn pennypincher.

Mr. O'Green. I should point out Mr. Erb is an Academy graduate, former commander of submarines and surface ships, and he didn't have quite that kind of quarters when he was there.

Mr. Erb. But it's a judgment factor, and I am not today facing the cruise and retention problems and things that the Navy is living with.

Mr. O'Green. I offer to you our people advising me on this hearing. Maybe I should offer my office as a comparison. I am not sure what I would do compared to a man at sea defending our Nation.

Senator Percy. I might also say the Senate of the United States has been subject to judgment factors on whether or not they put gymnasiums in, things of that type, and restaurants, and so forth. At least before they were completed, the judgment was made that they were not good ideas in stringent budget times, and we eliminated them. We have the same kind of problems, and I feel the communications we have had from the Navy indicate the Secretary of the Navy's concern, Chief of Naval Operations' concern, and I imagine the practices will be stopped, and I think they will stop it at the source when the story gets around, as undoubtedly it has.

Are there any other further comments from my distinguished colleagues?

Mr. ERB. I can add to that, that the effect has already taken place, and we know we are not going to get those kinds of requests for the wardroom on the *Yorktown*.

Senator PERCY. Thank you very much, indeed. I think this is the nature of the democratic process. It really does work although sometimes it is a little slow and sometimes a little embarrassing. Thank you very much for your candid, straightforward, and complete testimony. I would like to say there has been total cooperation between the company, the parent, and Ingalls itself with the subcommittee for which we are most appreciative. The hearing is recessed until——

Senator STENNIS. Mr. Chairman, may I make just one point? I thank you for your courtesies, and the chairman, too. At some time before you close the record, I want to file a short statement based on my experiences here in the subcommittee.

Senator PERCY. The record will be kept open then, Senator Stennis, for such a statement.

[The prepared statement of Senator Stennis follows:]

PREPARED STATEMENT BY SENATOR JOHN C. STENNIS BEFORE THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Mr. Chairman, I would like to take this opportunity to commend you and the members of this Subcommittee for the excellent manner in which these hearings have been conducted. The Subcommittee staff also deserves much credit for the excellent work they did in preparation for the hearings. The efforts of everyone involved have contributed toward making this a highly effective and beneficial hearing for all of us.

The allegations concerning Ingalls Shipbuilding in Pascagoula, Mississippi concerned me greatly until I had an opportunity to hear the full facts as presented before this Subcommittee. I always had the utmost faith in the good character, honesty and integrity of the management of Ingalls and that faith has been reinforced by the Subcommittee's investigation and the other information brought forth here.

The evidence presented during these hearings does not impute, much less charge, management at Ingalls with any wrongdoing. It is clear that the intent of Ingalls management is to closely follow the good and honest policies the company has established.

I have great pride in the achievements of this shipyard which has grown into one of the finest in the nation. I know it is an asset to the Navy and to the nation. Ingalls turns out some of our best destroyers, LHA ships and cruisers. The quality of workmanship at Ingalls has been outstanding, as all have testified during the course of these hearings. I am confident they will continue to produce the kind of ships which are essential to maintain U.S. naval superiority.

Mr. Chairman, I appreciate the courtesy you have extended me in allowing me to sit with the Subcommittee throughout these hearings. I have heard every witness who appeared before the Subcommittee, and feel I have benefited very much from being here. Again, I commend you on the thoroughness of these hearings and thank you for allowing me to participate.

Senator **Percy**. The hearing is recessed until 3:30.

[Whereupon, at 2:08 p.m., the hearing recessed to reconvene at 3:30 p.m. the same day.]

AFTER RECESS

[Members present after the taking of a recess: Senators Roth, Cochran, and Stennis.]

Chairman **Roth** [presiding]. The subcommittee will please be in order. I apologize for the interruption of your testimony, Mr. Erb. We ask you to please proceed.

Mr. **Erb**. Thank you, sir. I appreciate this opportunity to continue.

At the time we interrupted, I was discussing the time charging, and I will pick up from there. Chart 4, please. The 18,000 hours that were misassigned are from among more than 93 million manhours worked and charged directly to contracts at Ingalls during the period over which this misassignment occurred.

Said another way, the misassigned hours represent the total time of about 2 employees out of 10,000 for that time period. And reference to the chart, I tried to show to scale the magnitude of the thing we are talking about with respect to our total business; to scale down in the righthand corner are the dollars that would be associated to the 18,000 hours of mischarging. That bar would be one-tenth of 1 inch wide. The total dollars represented by direct labor only for the shipyard during that period, that bar would actually be 44 feet high.

Stated another way, it is less than one-tenth of 1 percent of our business.

Although the error rate is very low, the misassignment occurred in violation of company policies. It was caused by a very few lower level management personnel, as you heard testified to today. That is a very simplified diagram of the organization in the yard. In the blue area, six levels down—actually seven from the chairman—represents the area where these violations occurred.

What we are saying, there are 2 and possibly up to 5 people involved out of a total of 500 in that management organization, or about 1 percent.

With regard to the hours themselves, I would like to separate them into two groupings: commercial work misassigned to Navy contracts, and Navy-to-Navy contract misassignment. During the period under discussion, an estimated 3,081 hours were improperly charged from commercial work to Navy contracts. Some have inferred that this significantly improved our position on the unprofitable drill rig programs that were underway in our shipyard at the time.

[At this point, Senator Nunn entered the hearing room.]

Mr. **Erb**. Examination of the dollar amounts involved shows that could hardly be the case, not on a program in excess of $400 million cost being relieved by some $66.000 of misassigned time. Here, again, I have used the same technique in displaying the relationship between those two numbers.

Certainly no management would risk fraud charges for those returns and, indeed, Ingalls did not. And even if one confines the comparison of misassigned hours only to engineering costs, it is obvious that even engineering had no planned and orderly program for conducting fraud.

We have here the value of the engineering hours expended on the drill rig program expressed in terms of dollars and, again, the value of the misassigned hours in engineering from the drill rig work to Navy programs.

As a part of Ingalls' internal investigation, we found that during the period of about September 1978 until 1981, between 10,000 and 15,000 engineering manhours had been misassigned between Navy contracts, meaning that work was performed on one Navy program but the time involved was actually charged to another. It involved work done on the CG–47 cruiser and misassigned to the DDG–993 and 997 programs.

The 10,000 to 15,000 hours were among more than 6 million engineering hours worked by Ingalls during this period. While misassignment was wrong and in violation of the policy, it is important to understand that such misassignment does not mean that the Government paid for something it did not receive. To the contrary. The Government did receive appropriate service, but the proper Government contract was not charged for the work. Ingalls in no way benefited financially or in terms of cost performance by this misassignment.

Ingalls could have benefited only if it made a contract whose profit depended heavily upon subjective evaluation of cost performance appear much better than in fact it was.

And I would like to go through a series of four charts here to demonstrate this particular item. You see before you the comparison of the 15,000 man-hours that were mischarged, taken off the CG–47 program and moved over to the 993 and 997. The actual cost on the 47 program was some $385 million. That number, $385,000, is certainly way beyond the accuracy to estimate a program of this duration and complexity. We are talking about a 4-year contract. There is no way we can estimate such things as energy costs, workmen's compensation, what we are going to have to negotiate with our unions. These contracts are of such duration that they extend across more than one labor contract. Again, we are talking about a very, very small number, unacceptable as far as I am concerned, but we shouldn't get confused and draw conclusions that are not there.

Let's address the issue of, could we make ourselves look better on the CG–47 program and would that benefit the company? I have shown here the value of the engineering hours that have been expended on the CG–47 and, again, value of mischarged hours. You see it is a very, very small percentage. It is about five-tenths of 1 percent. Next chart, please.

This morning, some discussion took place regarding the factors that are considered in award fee, and I should make an aside at this time. There was discussion that set cost at very low priority. That was on the prototype ship only. If I were to show you the pie for the following ships, it would be very different. Cost is probably up in the 45- to 50-percent range. Here are the facts on the 47 program.

We are now some 18 quarters into that program. The ship has been delivered. She is out and operational now. She will be returning to the yard for a very brief period this summer, and that will be the end of our involvement with that program.

During those 18 quarters, the amount of award fee that was available was some $30 million, and that award fee is dispensed quarterly on the basis of evaluations made during that quarter so that the average award fee that was available per quarter was about $1.7 million. Only 15 percent of that could be influenced by cost. So now we are talking about $254,000 average award fee that could be attributed to our cost performance.

Let's assume for the moment that I had been able to take my grade from 60 to 80 by moving those hours, would that have made any business sense? In fact, I would have achieved about $60,000 improvement in that award fee. Let's go to the next chart and see what price that would be. I moved—not I, the costs were moved to the 993 and 997 contracts, and what was the impact? Both of those contracts we were operating under target costs which meant that every dollar saved, I was getting 20 cents and returning 80 to the Navy—30 cents, I should say. The minute I transfer a dollar of cost out of the 47 program into this one, I lost 30 cents right there. So I am going to transfer $345,000 and in so doing. I will lose $130,000 to gain $60,000. It makes no sense.

While misassignment did occur, it did not occur——

Senator NUNN. May I ask a question here, Mr. Chairman, just briefly? What you are saying is switching hours from one of these contracts to another, even though the people who did it may have felt they were benefiting either themselves, making themselves look better, perhaps they even thought they were helping the company, it was detrimental to your company and not positive; is that right?

Mr. ERB. Absolutely. Every dollar they transferred to those two programs, if I got no increased benefit on the 47, as I have shown it is a very small amount, I immediately lost 30 cents; the Navy benefited by 30 cents because they would have otherwise given me 30 cents of that dollar.

Senator NUNN. So for someone to conclude this was a high-level management conspiracy, they would also have to conclude you are poor business people.

Mr. ERB. They would have to think we are very stupid, and I think my boss would do something about that.

While misassignment did occur——

Chairman ROTH. If I could, I think it is important for the record to be clear, No. 1, I don't think the charge has been made that this was directed by high-level management. The evidence was to the latter; it is very minimal.

Senator NUNN. I agree with that.

Chairman ROTH. I want to make that clear.

Senator NUNN. I don't think it has been made at this hearing, but it seems to me from what I have heard, it has been made or implied in a good many reports that have been out. I certainly don't think the staff made—in fact, just the opposite. Our staff, I think, made it very clear they did not trace it beyond the second and third level, but from what I understood about some of the media reports, the implication has been rather strong that it was widespread, if not top management.

Mr. ERB. I am presenting this data in the light there has been mischarges and what could have been the possible motive for it. That is the light I am presenting this in.

Chairman ROTH. I would make two other observations. One, not necessarily drawing any conclusions, as I understand, 993 and 997 was a new program of——

Mr. Erb. No.

Mr. Weiland. 997 was the last destroyer; is that right?

Mr. Erb. That is right.

Mr. Weiland. The CG–47, of course, was the first cruiser.

Mr. Erb. Correct. If you look at the chronology of ships at Ingalls, you had the 963, the *Spruance* class destroyers. We built 30 of those and about halfway through the process of building those 30, there was one more of those ships ordered. Then they took the combat suit that is normally carried aboard the nuclear cruiser and adapted it to this ship, and that is the *Kidd* class destroyer. We then took basically the same hull, machinery, that sort of thing, and adapted the Aegis weapon system to that ship so that is really the third generation of the root ship, and that is the CG–47. That is the chronology in which those ships flow at the yard.

While misassignment did occur, it did not occur for the reasons that had been alleged, nor with the consequence of the Government contracts, as has been suggested. The facts are clear on this. Why, then, did it occur? What was the objective of those few employees who were involved?

There was no personal gain for those employees; none was possible. After more than 3,800 hours of internal review, audit and investigations, we have concluded that a combination of management pressure and individual convenience were major influences.

Chairman Roth. Can I ask when that conclusion was reached?

Mr. Erb. As part of the entire process.

Chairman Roth. You say after completion of the 3,800——

Mr. Erb. Those 3,800 hours are the audits that supported both the "60 Minutes" effort and the committee's effort.

Chairman Roth. That is a relatively recent conclusion?

Mr. Erb. That's correct. That is when it came to management,'s attention, and we started asking ourselves why. Why did it happen? Why did they do it? And I think, as has been borne out by some of the testimony here, those are not conclusions that are peculiar to us. Others have also reached those conclusions.

Filling out a timecard can be very inconvenient and complex for one whose day is spent working on several different contracts. And I have included in the minutes here an outline of what a timecard might look like. This is an actual timecard of an engineer who, in the course of 1 week, worked on five different contracts.

This is complex, and it is cumbersome for the individual. Therefore, there is a temptation to simplify. It can also appear frustrating to an individual to go get additional budget for an emergent task, so one might be tempted to temporarily borrow from an existing already approved budget in anticipation of the budget for the new task. That is what I mean by convenience.

What about management pressure? I have said earlier our company strives for constantly improving performance. I do not apologize for making people budget-conscious at Ingalls Shipyard. I only regret that a very few chose to react to that pressure through improper action.

Have we found all the misassignments? We believe we have. I can assure you that we have aggressively investigated, audited and followed through on every single piece of information we ourselves have developed or has been provided to us.

What if, by chance, we have not found all; would we change the overall conclusions? I think, if we can go back to the earlier chart I showed that shows the 18,000 hours as compared to the total value of direct labor—suppose that had been 30,000, as somebody suggested today, we would have had two-tenths of an inch to 44 feet. Suppose it tripled. Again, I don't think it is an attractive thing from a management viewpoint. There was no motivation for management. So, we believe that we have found all that has been indicated to us, but if we haven't, and I should say that this examination took place where we expended 3,800 hours, I would assume that DCAA, the Navy, the subcommittee and other people have probably spent sufficient numbers so that when added to ours, they are probably not too different than the 18,000 hours that were uncovered. Now, maybe if we expend another 3,800 hours, maybe we will find some more; I doubt it.

But in any event, I do not think it would change the general conclusions of what caused the problem.

I would like to now move on to the other subject I was asked to address, and that is what our company's policies are regarding whistleblowing. If you are asking us if we take action on information concerning possible wrongdoing that needs correcting, the answer is yes. Do we encourage people to come forward with such information? The answer is yes. Do we punish employees for going to legitimate government agencies with information about our company? The answer is no, and we never have. Do we punish people for going to legitimate press? The answer is no, and the chairman has already very eloquently stated my position regarding entertainment and non-official investigating bodies.

At Ingalls, it is the practice of management to create an environment that encourages employees to speak up about activities that are wrong and need correcting, and such environment does exist and it is achieving results. We have an extensive internal investigation and auditing program at Ingalls. At any one time, we have a number of investigative cases being carried on.

Approximately 90 percent of all of our investigations at Ingalls are initiated or aided by information supplied by concerned employees.

[At this point, Senator Nunn withdrew from the hearing room.]

Mr. **Erb.** Employees call, send letters, and supply information by other means. Sometimes this information comes to us anonymously. In all cases, the identity of the persons providing information is kept strictly confidential, and I know of no instance—and I repeat, no instance—in which an employee has suffered adverse consequences as a result of having come forward with information.

I could present to you a number of factual examples of which information voluntarily furnished by Ingalls' employees has resulted in company investigations and audits which have revealed activities that need correcting. One such case is still current, and I wish to share with you some of the details.

An employee contacted the head of our investigating staff and provided some information which indicated some irregularities in the handling of petty cash invoices in one area of our shipyard operation. Following an 8-month investigation which involved the methodic review of thousands of petty cash invoices, five Ingalls employees, including a member of management, were discharged in connection with the submittal of more than $130,000 in bonus petty cash vouchers.

Our investigation shows, using unauthorized invoices from a number of companies, those employees were forging the names of their supervisors on company vouchers and were being reimbursed for material which they claimed they purchased for the company but, in fact, did not. The five employees were discharged and the appropriate Navy contracts were adjusted.

Since Government funds for Navy contracts were involved in this case, as well as funds for commercial programs, the results of our company investigation had been shared with the FBI. Two weeks ago, a Jackson County, Miss., grand jury indicted two of these former employees on charges of false pretenses. The FBI investigation is continuing.

I think it is important to make one additional point in connection with the case I just described to you. Two of the former Ingalls' employees who were discharged for their participation in the petty cash scheme have made serious, false allegations about our company in interviews with the CBS show "60 Minutes." They have also been interviewed by the investigators of this subcommittee. Those interviews took place months after their discharge from Ingalls. The allegations they have made were never brought to management's attention prior to their discharge. But more important to the point of these hearings, the allegations they have made have been proven to be incorrect. A full investigation and audit by Ingalls have shown the allegations to be without foundation and information associated with the audit has been made available to the FBI and this subcommittee. Ingalls——

Chairman ROTH. If I might interrupt there, I think the record ought to show also you are correct; the subcommittee did investigate those charges and also agreed with the company there was no substance to the charges.

Mr. ERB. Ingalls' internal investigations and——

Mr. WEILAND. Excuse me—let me interrupt. Senator, there were some things we followed up on that we found were not credible. However, with respect to the allegations, I think, that Mr. Erb is referring to here, our own review of the payroll records as recited by Mr. Rod Smith this morning, indicated that, in fact, the witness was telling the truth with respect to the charging of certain employees in the shop.

Mr. ERB. I believe you are referring to the preplanned charging sheet. Ingalls, in fact, did conduct an audit taking those sheets and taking the computer printouts of how the hours were actually charged. There was 25-percent variation between the planning sheet and the actual hours.

Ingalls' internal investigations and audits, many of which are conducted in conjunction with the FBI and the Naval Investigation Service, have resulted in the recovery of hundreds of thousands of dollars in Government funds and property. But equally important, these investigations reflect our company's aggressiveness to protect that which has been entrusted to us.

In our investigations and audits, we seek not merely to discover or uncover. When we find wrongdoing, we stop it. We make every effort to recover funds and property which may have been misappropriated. We take appropriate internal disciplinary action and, where warranted, cooperate with proper authorities in prosecution of individuals who have broken the law as well as violated our policies.

And finally, as part of our investigative and audit process, we review our systems and controls to determine what we can do additionally to make them less vulnerable to violation.

At Ingalls Shipbuilding, the quickest way to get corrective action is come to us, management.

We have responded in the thorough and timely manner to each and every request made of us by the subcommittee. We have cooperated because we have nothing to hide, and we want to thank you for all your time today in permitting us to put our position on the record.

Chairman ROTH. Thank you, Mr. Erb. First, let me say to both you and the chairman of the parent organization that there has been no charges by this subcommittee with respect to the quality of your work, with respect to your contribution in producing not only ships but other equipment for the Federal Government. The only area we really are investigating is one location and the question of mischarging.

I think it is important for the purposes of the record to understand that it was made very clear by the staff members who made the beginning report that there was little evidence showing that these cross-charges were due to planning or action on the part of top management, either of the parent organization or the subsidiary Ingalls.

I would like to go, if I might, to the first area that you answered at our request. That is the question of the kind of contract. It is my understanding that you feel, Mr. Erb, that in contracts involving cruisers of the type we are talking here, CG–47, that those should be under a cost-type reimbursement plus incentive fee and not a fixed-price contract; is that correct?

Mr. ERB. With the current state of the design, if you look at the next ships coming down the line, there are some rather significant changes being made. Let me give you one as an example.

At Ship 52, CG–52, we will be installing a vertical launching system in lieu of the complex mechanical launchers that are there now. This is a significant change in the ship, and there are similar things like that going on. We also have a major effort in cooperation with the Navy going on to regain weight and stability on the ship, not that the ship has a problem in that regard, but to provide for future growth in that ship. As more sophisticated weapons become available 10 years from now, you can update the ship and have a modern ship.

Those are the reasons I say it is not appropriate at this time.

Mr. O'GREEN. Mr. Chairman, might I add a thought to that as well? The corporation underwent a difficult time period with respect to the shipbuilding program and the company was very much at risk. We made a policy decision within, that on first-of-a-kind, first-of-a-class where you didn't have fixed drawings, we would not enter into a fixed-price agreement again. I think time has moderated that to some amount, but I think the point we think is so important, and the reason we offer cost type as the way we think contracting should be done in this case, in that shipbuilding is totally different from all the other things that we do and what others do as well.

In the process of other contracts, such as Air Force contracts, there is an annual update——

Chairman ROTH. I am sorry?

Mr. O'GREEN. They are tied in over a period of time, maybe on an option basis over this period, but we have a circumstance where we sign contracts that last 10 years at times. We don't have sufficient protection with respect to inflation costs, energy costs, labor movements and all the things that go with it, and there is no update period allowed on an annual basis in this case.

So our attitude is, while we recognize the opposition that many in the Government have had to cost-type contracts because the contractors run-away and grow organization, we don't want more people—that is the last thing we need in our company. I am participating——

Chairman ROTH. You don't want more what?

Mr. O'GREEN. People in our company. We don't want more employees than we need. In our case, when we come back and give you a competitive bid on a cost-type basis, I can give you a cost I don't have to protect on the basis if I have something that arises, we don't know about that will add to the cost of the contract. That has to go in a base-fixed price or I leave myself in the position that it is high risk in terms of completion, and the Government loses in the prospect. The reason they lose, each time we want to make a change, we have negotiated activity that takes months, data, negotiations where the cost-type type of procurement where we are making changes Mr. Erb is talking about, that happens quickly because the cost is going to be there in the end and the estimated process becomes a different one and you don't have to put in for protection for things you don't know about.

Mr. ERB. May I address one other point, Mr. Chairman? The Navy has not felt itself totally at our mercy. They have, in fact, given us a contract, Ingalls, to support bringing Bath Ironworks on the yard into the program as a second source for these ships. They, in fact, have awarded a cruiser to Bath at a higher cost than that cruiser could have been built at Ingalls. However, they now have a position when ships come up, they can get a competitive bid and a cost-type environment from two competent shipbuilders, and I believe that gives the protection that the Government needs so that some of the bad things you heard about cost-type contracts simply can't happen. I wouldn't get very many of the ships, if that were the case.

Chairman ROTH. In your statement, you say the cost-plus-incentive-fee contract does provide for proper risk sharing and gives the Navy the flexibility to make the changes needed to insure an effective warship delivery. That is true as far as flexibility is concerned. It is the simplest——

Mr. ERB. They can introduce a change. They can simply——

Chairman ROTH. Isn't it also true there is very little risk sharing under a cost-plus-fixed-fee? Aren't you entitled to all legitimate costs under that contract plus a fee?

Mr. ERB. That's correct.

Chairman ROTH. So there is not much risk sharing. I am maybe picking at your language.

Mr. **Erb.** If I don't perform——

Chairman **Roth.** Then you don't get the fee, theoretically.

Mr. **Erb.** I get 3-percent fee.

Chairman **Roth.** Your costs themselves are reimbursed—legitimate costs are reimbursed?

Mr. **Erb.** Yes, sir.

Mr. **O'Green.** Mr. Chairman, I would like to point out, in prior testimony to this body, we have taken the position that in order to give you that protection, that the incentive should be a plus/minus affair so that a negative incentive would be earned for poor performance, that would take you down to stopgap, which is, say, minus 10 percent, if that is the way it came out. That establishes the motivation tied to cost so there are ways the Government can contract and protect itself in that process.

Chairman **Roth.** A negative disincentive fee.

Mr. **O'Green.** We would actually lose, plus/minus 10 percent and base it on a cost performance basis. We actually have had contracts before performed on where the target cost was the minus 10 percent, and you only got to zero by being good.

Chairman **Roth.** But that is not a general approach of using a negative fee on the part of the Navy.

Mr. **O'Green.** No; we have none. It has not been accepted. I think one of the other things as sort of an underlying benefit that goes with the cost-type procurement versus fixed-price procurement, and I think I should say for the record that in our defense electronics, 90 percent of our contracts are firm, fixed-price contracts or fixed-price, incentive contracts, and that includes the high-tech kind of things you do inertial navigation, and we are very successful with that.

It isn't that we are allergic to doing that. When you come to fixed design in ships, we can bid that, but we have to have certain protections for the time involved.

Chairman **Roth.** I will have to say candidly that I am concerned that the use of the fixed-price competitive bid has gone down in the last 10 years and that is a development I look upon with great concern.

I recognize there are circumstances and situations and obviously a lead ship is not one ordinarily that you would want to put out on a fixed price.

Mr. **O'Green.** There is also another specific that goes beyond the lead ship. While in the process of doing the lead ship, you don't have return cost on labor and material until 3 or 4 years down the road. The conversion-type contract—cost is determinable with a fixed price—might be appropriate on the following ships.

Chairman **Roth.** I would like to, if I could, turn to the question of mischarging. As I said earlier, I think there is some agreement—there is agreement—that there was some mischarging at the facility at Ingalls. I think it is a fair statement to say there is agreement that accurate timecards are important both to the contractor and to the Federal Government. I would like to ask you, Mr. Erb, you say in your testimony that 66 employees were discharged. Are you familiar with those cases?

Mr. **Erb.** Not each one individually; no, sir.

Chairman **Roth.** I wonder if you or if any of your people here could tell how many of those employees were discharged because the individuals fired either put in additional time for themselves or friends of theirs; how many were discharged because of mischargings?

Mr. ERB. We will provide that information for the record.

[The information referred to, which was subsequently received by the subcommittee, follows:]

In its various responses to the Subcommittee's repeated requests, made before, during, and after the May 3–4 hearings, Ingalls Shipbuilding Division failed to cite a single instance in which an employee had been discharged for falsifying time records to benefit the company rather than the individual employee. See, for example, Ingalls' final response, dated June 28, 1983 which follows:

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
Washington, D.C., June 16, 1983.

GEORGE HOWELL, Esq.,
Vice President and General Counsel, Ingalls Shipbuilding Division, Pascagoula, Miss.

DEAR MR. HOWELL: In the course of his testimony before this Subcommittee on May 3, 1983, Leonard Erb stated that certain statistical data concerning Ingalls' internal disciplinary proceedings would be provided for the record. A copy of Mr. Erb's recorded statement is attached. This is the same data you and I discussed last week by telephone.

To date, we have not received the information. As the record is presently being kept open for the sole purpose of including this information, would you kindly see that it is provided as expeditiously as possible.

Thank you for your prompt attention to this matter.

Very truly yours,

RODNEY G. SMITH,
Deputy Chief Counsel.

Enclosure.

INGALLS SHIPBUILDING DIVISION,
LITTON SYSTEMS, INC.,
Pascagoula, Miss., June 28, 1983.

Mr. RODNEY G. SMITH,
Deputy Chief Counsel, U.S. Senate, Permanent Subcommittee on Investigations, Washington, D.C.

DEAR ROD: I referred to our Industrial Relations Department your June 16 letter, in which you requested that we provide the answer to Senator Roth's question (page 182 of the hearing transcript) concerning the number of Ingalls employees who have been discharged because they either put in additional time for themselves or put in time for other employees.

They advise that during the period of January 1977 through April 1983, 49 Ingalls employees were discharged because of timecard violations in which they themselves received pay for time not worked, or assisted other employees in receiving pay for time not worked.

I am also enclosing a copy of G. M. Canaga's memo to G. J. St. Pe' dated April 15, 1983, sent to you by my letter of April 15, 1983, and a copy of my letter of April 29, 1983 to you giving further clarification.

We will be most pleased to provide additional information you may need on this matter.

Sincerely,

GEORGE W. HOWELL,
Vice President and General Counsel.

INGALLS SHIPBUILDING DIVISION,
LITTON SYSTEMS, INC.,
Pascagoula, Miss., April 29, 1983.

Mr. RODNEY G. SMITH,
Deputy Chief Counsel, U.S. Senate, Permanent Subcommittee on Investigations, Washington, D.C.

DEAR ROD: On April 15, 1983, I responded to your letter of March 24, 1983 by enclosing a copy of G. M. Canaga's memorandum to G. J. St. Pe' dated April 15, 1983, on the subject of "Disciplinary Actions for Time Card Falsifications."

In subsequent conversations with me you advised that the memorandum sent had assumed a definition for "systematic falsification by a supervisor of records pertaining to his subordinates," different from that which you had in mind. You advised that by the term "systematic" you were referring to situations similar to the recent situation involving the Engineering Department which you have had under review.

I discussed this with Jerry St. Pe' today and he cannot recall a similar situation occurring at Ingalls. Mr. St. Pe' has been head of Industrial Relations for eight years.

Very truly yours,

GEORGE W. HOWELL,
Vice President and General Counsel.

[Memorandum]

INGALLS SHIPBUILDING,
April 15, 1983.

To: G. J. St. Pe'.

Subject: Disciplinary Actions for Time Card Falsifications.

Three questions were raised by the Senate Investigating Committee concerning the previous information submitted on disciplinary action taken for time card falsification. Those three questions as related to me over the phone were:

1. The number of cases involving individual falsification or falsification by an individual and co-worker.
2. The number of cases involving falsification by a supervisor and a subordinate; the term systematic was used here. In lieu of a definition of systematic, we are including as the response to #2 all cases involving falsification by a supervisor and the sub-ordinate.
3. How many cases resulted in the discharge of the employee.

The statistical information is as follows:

1. 45 cases involving 72 individuals and co-workers occurred.
2. 53 cases involving 93 people occurred with a supervisor and sub-ordinate(s).
3. 56 cases involving 66 individuals resulted in discharge.

In summary, a total of 98 cases involving 165 people resulted in disciplinary action for time card violations; of those 165 disciplinary actions taken, 66 resulted in discharge. Names are available upon request.

G. M. CANAGA.

Chairman ROTH. Would you have any idea now?

Mr. ERB. No, sir, I do not.

Chairman ROTH. Are you aware of any of your employees' being discharged for mischarging?

Mr. ERB. You mean individually by name?

Chairman ROTH. Individually, by name.

Mr. ERB. I am not, sir.

Chairman ROTH. Are you familiar with the policy requiring the termination of an employee who misstates his timecards?

Mr. ERB. Up to termination.

Chairman ROTH. Including.

Mr. ERB. It's a judgment. Each case is looked at individually. We don't treat people by numbers. We treat them as individuals and we examine the case, and I always get a recommendation from two people regarding the discipline of these kinds of activities.

Chairman ROTH. Do these terminations come to you?

Mr. ERB. They are discussed with me; yes, sir. Direct recommendations are brought to me. In most cases, there might be some mechanical cases, like the guy didn't show up for 1 day and somebody else punched out his timecard, that probably wouldn't come to me, but where there is a judgment factor involved, it comes to me.

Chairman ROTH. What would be a sufficient number of hours to warrant discharge, in your judgment?

Mr. ERB. The first test I make is, did the individual personally benefit?

Chairman ROTH. Did the what?

Mr. ERB. Did the individual personally benefit from the mischarge? Pretty clearly if that were the case, they would have a hard time convincing me we shouldn't discharge that person. You might ask, well, what about when you are mischarging and the customer suffers the consequence? That becomes a judgment factor. I have heard considerable testimony today that maybe I am driving people to that, I am too tough on them. If that is the case, and I know I am tough on them, then maybe I need to show a little mercy when they react in the wrong fashion. I don't have a number that says, if you mischarge 500 hours you are fired; if you mischarge 499, I'm going to demote you. It's an individual case.

Chairman ROTH. I understand it is not mechanical. In other words, there is a distinction drawn in your policy between those employees who improperly submit timecards where he personally benefits?

Mr. ERB. I am not sure if that is spelled out in policy. That is our practice in administering that policy.

Chairman ROTH. Let me ask you this question: We have a case where three employees, three engineers are involved in mischarging from the oil rigs to Government contracts, and their discipline was a reduction in their merit increase; is that correct?

Mr. ERB. The initial one; yes, sir.

Chairman ROTH. Let me ask you this: On page 13, you were speaking about the accuracy of records. You say:

> As a management, we have been aggressive in enforcing the policy. We conduct periodic audits to verify that the policy is being followed and when it is not, we take corrective action. We administer discipline to those in our work force who, for whatever reason, violate the policy.

Let me say that, just as one Senator, that I view mischarging of the Government for hours not worked on a Government contract equally serious with that of the employee who does it for personal gain or another employee. I urge if you are going to have an aggressive policy—the only thing we are concerned with today is mischarging, and I would urge you to go back and study that policy because I think it is critically important that every employee at your facility fully understand that cheating the Government, and that's what it is; I don't care if it is $5,000 or $50,000 or $100,000, it is cheating, stealing from the Government, and it must be treated at least with the same toughness as the one who tries to personally gain.

Mr. ERB. I accept that.

Chairman ROTH. Let me be very clear with you. I am not trying to make anybody a victim or anything, but I am going to see to it as chairman of this subcommittee that every contractor understand the seriousness of mischarging. I don't want you to get any idea you are singled out because you are the first one we brought before us. But a second point that, again, candidly bothers me is that in reading and listening to your testimony, we do concentrate on this one incident you say in your testimony 10,000, 15,000 hours. I think it has been raised to 18,000. Some of our people say 30,000, and I am not here to quibble between the 10,000 or the 30,000, but I do think it should be clear that there is more than this one incident. There are other audits that raise some very serious question that at the lower level there is mischarging.

Again, I am not trying to trace it to either you or your top management, but I think it is significant and bothersome to me, at least, that we have a number of audits by your own internal audit people, and this has already come before us, where you auditors write that the "Above findings would normally result in a recommendation to reclassify to indirect those employees performing functions recognized as indirect. It is recognized that to reclassify employees at this time would create budget problems." That was included in an audit report on March 25, 1981; March 9, 1981; April 9, 1981; May 1, 1981. Now all of those——

Mr. **Erb.** May I comment on that, sir?

Chairman **Roth.** Certainly in just a minute. All of those infer that budgetary matters were more important than correct classification. I think that is a serious matter. It is not just one incident, and let me say, I think if a man—if an individual distorts his pay by putting hours that he did not, whether it involves $50 or $500, it is still a serious matter. And I think it is a serious matter here to have your auditors, presumably your first line of defense to protect the Federal dollar, to be writing in their own report, "It is recognized that to reclassify employees at this time would create budget problems." Would you care to comment?

Mr. **Erb.** He is referring to internal budget problems, not problems affecting the customer. We use cost data that very carefully track and compare our performance. For example, I will look at the pipe costs to build the first ship and if the pipe costs to build the second ship don't show improvement, then we go work that problem.

If I am constantly shifting the category and the way people charge, then I lose my baseline. That, I believe, is what he meant. I don't believe it was implied to be that we would have a budget problem between the contract and ourselves. It was internally where we budget direct and indirect and we track very carefully to that.

I try to establish ratios on the numbers of indirect people I have to the number of people carrying tools. If, all of a sudden, we reclassify 500, I have lost my baseline, and I don't know whether I am improving my performance again. It would take about 6 months to settle back out before I can reestablish my baseline and be sure that I am getting the performance I am looking for. Going from indirect to direct in a yard like ours when there is almost no commercial work at this time, zero work has no impact upon the cost of the contract.

Chairman **Roth.** No. 1, I don't want to go into the position that accuracy is not important because I think you yourself agree it is important to you and important to the Government to understand what the costs of particular ships are. I don't want to get into a lengthy discussion, but, nevertheless, I would just point out in a number of cases, and these are your audits, November 1980, supervisors mischarging to make up from week before; mischarging a growing trend; auditors recommendation tell them not to do it.

May 1, 1981, three directed mischarges found in other cost sector. Auditors say reclassification would create budget problems.

April 9, 1981, while findings described above were normal result and recommendations and reclassification to change classification at this time would create budget problems.

March 25, 1981, employees charged to contract without considering the contracts on which they actually worked.

In any event, we have been told that the director of audit has no authority——

Mr. ERB. That is absolutely incorrect.

Chairman ROTH. What do you expect him to do?

Mr. ERB. Let me tell you. When he makes an audit, he goes around and he makes a recommendation on the corrective action, and he discusses it with the director involved. My staff is then briefed on the audit and the corrective action, and if they cannot reach agreement, it is brought directly to me and I make a decision.

Chairman ROTH. I would also like to mention a number of DCAA audits. Here, again, we have a number of audits beginning in 1977 through 1981 where the DCAA raises questions. For example, February 24, 1977, it said, among other things, "Such charges to wrong contract has potential annual cost of $573,000 just for employees caught on floor check."

March 12. 1980, "Cross-charging has the potential annual impact of over $3 million, certainly not insignificant."

March 11, 1981, "Seven percent mischarged rate is insignificant and not worth discussing."

I am going to ask the DCAA tomorrow why they don't think 7 percent is significant.

We have a number of these right up through June 15, 1982—rather, November 11, 1982—where a DCAA audit also discussed mischarging rates.

The point I want to make is that I don't think it is accurate, and where I have problems with your testimony is to infer this one case, or this one shop, is necessarily the only source of the problem. There are, in my judgment, a number of audits made by your own internal people as well as DCAA that raise some very serious—substantial—problems. I would urge you to go back and make it clear that that is not going to be tolerated.

Mr. ERB. May I make one comment?

Chairman ROTH. Please do.

Mr. ERB. On actions we have taken. It is implied here that all the charging was confined to the pipe design department and that is all that was examined. Maybe it is all through the rest of engineering. We ask ourselves that question, too, and we get the engineers together—Jerry St. Pe' who conducts investigations, and vice president of engineering got the engineers together in groups of 400 each and clearly asked every one of them, "If you know of any additional mischarging, come forward."

We had a second meeting where we got all the supervision together and again went through those same things. And as has been indicated, even with all of that, one of our employees went forward to your investigators who had attended those meetings and gave them information he wouldn't give us.

I point that out only to say that we are not sitting there doing nothing. We are aggressively pursuing the problem.

Chairman ROTH. This is my last question for the moment. I just want to point out we are not only talking about piping design, we are not only talking about submarine planning, material storeroom, so there is at least some evidence that cross-charging or mischarging has been happening in more than one area.

I would like to, if I might, turn to the question of the so-called whistleblowers. In your statement you say, "I know of no instance in which an employee has suffered adverse consequences as a result of having come forward with information."

How would you reconcile that with Ms. Sigalas and Mr. Fite? You were here when they testified earlier.

Mr. ERB. Ms. Sigalas resigned by her own admission. Mr. Fite, and right in front of me is the chart that shows the employment levels, and if you will look at the period we are talking about, we are going from 18,000 employees to 11,000 employees. That is the time we are talking about with Mr. Fite. Mr. Fite was a carpenter, and within the carpenter trade, there is not a special category of diver. That is an additional job he can take on, but there is no seniority among divers. There is only seniority among carpenters.

And in response to that layoff, we laid off 17 people the day Mr. Fite was notified. If only two had been laid off that day, he would have been laid off. He was fortunate in that we were able to place him in another craft in the yard until that work fell off.

Now, why did we train additional divers when he was an experienced diver? Our union contract requires us to discharge people in inverse seniority order, and he was a carpenter. So we had to go train other carpenters who were more senior and he himself said that the people we trained so that we would have a replacement for him were in the shipyard when he was hired. So there was no action taken against Mr. Fite as a result of the circumstances he described. It was our normal layoff procedure.

Chairman ROTH. Let me ask you a question with respect to Ms. Sigalas. Do you have a copy of the one letter? Do you have a copy of the letter she sent?

Mr. ERB. The only letter we had which was in her personnel record—and we keep personnel records of all employees, active and inactive—is the one that was presented to her today by Senator Cochran.

Chairman ROTH. She was under oath and she said she wrote the second letter. Are you questioning she wrote——

Mr. ERB. No, sir. You asked me, Do we have the letter? I said, "No," we did not. We carefully searched her file and the only letter we found there was the handwritten one that was displayed today.

Chairman ROTH. Did you discuss this matter with her supervisor at that time, the vice president who received it?

Mr. ERB. No; I was not aware of that letter.

Chairman ROTH. Senator Cochran.

Senator COCHRAN. Thank you, Mr. Chairman. When we were breaking up at about 2 o'clock, Senator Percy asked Mr. Erb a question about the basic order agreement. You may recall there was some discussion about the purchases of switches and valves or whatever other items of equipment that seemed to be charged to the Navy at unreasonably high costs. For your benefit, Mr. Chairman, I know you would like to have some explanation of that, and I would ask Mr. Erb if you would tell the subcommittee first what the basic ordering agreement is between the Navy and Ingalls. What does it encompass and how do you perform your part of that bargain?

Mr. Erb. We, in fact, have three basic ordering agreements as regards supply of parts. The purpose of those ordering agreements is for the Navy to be able to economically and quickly acquire parts that they need for the operating ships and, in fact, in response to some of their requests, we have taken material out of ships that were under construction so that we could support the shipping.

How is the contract administered? It is totally impractical, I believe, and I think the Navy has come to that conclusion, to individually order each one of those and go through the whole bid and proposal and negotiating process. So we sit down and negotiate with the Navy an agreement that assigns a certain number of hours to the processing of any order, be it for an $11 switch or $4,000 motor. There are other costs that are on a per-case basis.

For example, if we had to take that motor out of the ship, we are reimbursed for taking it out and putting another one back in. It is very difficult to negotiate fixed factors like that, so on about a yearly basis, we sit down and have a reconciliation. They examine all the orders they have given us, all our actual costs we provide to them, and they calculate what profit we make to see if we make an unusual profit. If they feel our profits are too high, then they adjust the factors. I think that the system has been very effective. I think the Navy has done a good job and there are the results of it.

Since 1975, we have supplied $10 million worth of material to the Navy, and we made 11.3-percent profit in that business.

Chairman Roth. I assume that profit is based on the cost of the material.

Mr. Erb. That profit is based on all the costs that are involved—our processing costs. We have to inspect the material, we have to package it, we have to guarantee that the vendor didn't give us a non-mil spec part which later breaks down in the electronic equipment. All of those costs.

It is not just a simple matter of picking something up out of the hardware store that was alluded to this morning.

Chairman Roth. Excuse me.

Senator Cochran. Let me ask you this, too. There was some discussion of these luxury items that are said to have been ordered by the Navy to put in wardrooms and captain's quarters and the like on some ships built at Ingalls.

To what extent are you involved in making decisions of that kind, and how do you go about satisfying the requests for outfitting in those specific areas of the ship?

Mr. Erb. The Navy normally allots some finite amount of money that can be used at the end of the construction period for those kinds of changes to the ship. Those funds are in the hands of the Navy. They determine what they want to do and in some cases they ask us to bring vendors in to talk to. They determine what it is they want and then they make an amendment to our contract to have us go buy that material for them.

And, in fact, it was alluded that we passed it to Litton. We didn't pass it to Litton. The Navy specified that they wanted us to place that order with Litton Office Products Pascagoula.

Senator Cochran. Is Litton Office Products Pascagoula a subsidiary of Litton Industries?

Mr. Erb. Yes.

Senator Cochran. Do you have anything to do with running Office Products, Inc.?

Mr. Erb. Not I.

Senator Cochran. Mr. O'Green, do you know how they would go about satisfying a request for procurement that was submitted by the Navy in an instance like that?

Mr. O'Green. If it's a request for purchase, we would quote a price to them for what they ask for; they spec it out to us. That would then be delivered to the shipyard.

Senator Cochran. Do you have any indication of profitability on the items that were identified today as being included on certain ships?

Mr. O'Green. The profit rate on that particular sofa, I am told, is low.

Mr. Robbins. 2.9 percent.

Mr. O'Green. 2.9 percent.

Senator Cochran. This was on the profit of 2.9 percent to Litton—on what item?

Mr. O'Green. That was on the sofa.

Mr. Robbins. The ——

Senator Cochran. Identify yourself for the record so we will know.

Mr. Robbins. I am Ed Robbins, vice president of administration at Ingalls Shipbuilding. The profit of 2.9 percent was on slightly over $300,000 worth of total business that Litton Office Products had done in this area, and this was the result of the DCAA audit that was made at Litton Office Products.

Mr. O'Green. The way we are organized in our companies, there are six different groups that report to our president and Office Products' activities falls within one of these groups, which is not Mr. Erb's group.

Senator Cochran. There was some discussion earlier—the chairman concentrated on it to some extent, quoting from internal audits and referring to DCAA audits on the subject of mischarging, suggesting there would be no reclassification or no reclassification was recommended because of difficulties with the budget, or it might cause budget problems, I think the chairman said. Isn't it a fact, though, that as a result of those audits, Ingalls did reclassify some 500 personnel in 1981?

Mr. Erb. That's correct—3 months after that audit.

Senator Cochran. So in spite of the recommendation by the auditors, it was management's decision to make changes to make the timekeeping records and procedures reflect accuracy in a greater degree than they had been in the past; is that right?

Mr. Erb. That is correct. The DCAA and the Navy are not without authority.

Mr. O'Green. Senator Cochran, the question of classification is not individual Ingalls, because all the activities we have in Government contracting have that same requirement.

Mr. Chairman, one of the things important about the discussion is there is a certain amount of gray area between ourself and the Government as to whether declassification is clearly direct or indirect. That is negotiated out each time.

Chairman Roth. Yes, I understand.

Mr. O'Green. The internal convenience factor in terms of the cost of doing it that way.

Senator Cochran. I have nothing further, Mr. Chairman.

Chairman Roth. Senator Stennis.

Senator Stennis. Thank you. I don't have any qeustions.

Chairman Roth. We will close down for this afternoon. Thank you for being here today. We will carry forward tomorrow at 10 o'clock.

Mr. O'Green. May I make one comment, Mr. Chairman? I would just like to be sure that you are satisfied with what you told us with respect to mischarging. We take a certain risk in displaying our data in this way because it seems to say we didn't condone the mischarging, and that is not the case. This shows clearly there was mischarging and we are aggressively going to pursue that and even more so after your comments.

The other thing I would say is that this was really provided to try to give you some assurances that that level, in terms of your defense procurement process, is not one that moves it by 50 percent or 20 percent or something like that in the total, and while it needs correction, and that is going to happen, I think the fact we are delivering at the rate and numbers we are that they are coming out very close even if the errors are there, the numbers being reported to you and for planning purposes.

Chairman Roth. I will probably have further comment tomorrow at the end of the hearing. As I said, I have been concerned by the fact that there were a number of audits that showed some problems. I hope we can proceed from there.

The subcommittee is adjourned.

[Whereupon, at 4:50 p.m., the subcommittee recessed to reconvene at 10 o'clock, Wednesday, May 4, 1983.]

IRREGULARITIES IN NAVY SHIP PROCUREMENT

WEDNESDAY, MAY 4, 1983

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The subcommittee met at 10 a.m., in room SD-342, Dirksen Senate Office Building, under authority of Senate Resolution 76, section 13, dated March 2, 1983, Hon. William V. Roth, Jr., (chairman of the subcommittee) presiding.

Members of the subcommittee present: Senator William V. Roth, Jr., Republican, Delaware; Senator William S. Cohen, Republican, Maine; Senator Thad Cochran, Republican, Mississippi; and Senator Sam Nunn, Democrat, Georgia.

Also present: Senator John Stennis, Democrat, Mississippi.

Members of the professional staff present: S. Cass Weiland, chief counsel; Eleanore J. Hill, chief counsel to the minority; Katherine Bidden, chief clerk; James B. McMahon and Rodney G. Smith, deputy chief counsels; Chuck Morley, chief investigator; David Glendinning and Tom Karol, staff counsels; Karen Hainer, investigator; John Sopko and Terry Bostic, assistant counsels to the minority; Glenn Fry, minority staff investigator; Sarah Presgrave, executive assistant to the chief counsel of the majority; Mazie Haley and Mitch Goldberg, subcommittee staff.

[Member present at the commencement of the hearing: Senator Roth.]

Chairman ROTH. The subcommittee will come to order.

[The letter of authority follows:]

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
Washington, D.C.

Pursuant to rule 5 of the Rules of Procedure of the Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, permission is hereby granted for the chairman, or any member of the subcommittee as designated by the chairman, to conduct open and/or executive hearings without a quorum of two members for the administration of oaths and taking testimony in connection with hearings on Irregularities in Navy Ship Procurement, to be held May 3 and 4, 1983.

WILLIAM V. ROTH, Jr.,
Chairman.

SAM NUNN,
Ranking Minority Member.

Chairman ROTH. Today, we will hear from a number of Government witnesses.

I would like to advise each of them that we are expecting a very busy day on the Senate floor so that I intend to expedite the hearing and hope to be completed by 12 o'clock.

For that reason, I would request that each of the witnesses or representatives, I guess I should say, who are appearing here today, summarize their statements so that we can proceed as rapidly as possible.

At this time, I will call forward Charles O. Starrett, Director, Defense Contract Audit Agency.

If you would please remain standing, raise your right hand.

Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. Starrett. I do.

Chairman Roth. Please be seated.

Would you please proceed, Mr. Starrett?

TESTIMONY OF CHARLES O. STARRETT, JR., DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

Mr. Starrett. Mr. Chairman, I have a fairly short statement that I would ask be put in the record. Since it is fairly short, I would like to walk through it with your permission.

[At this point, Senator Cochran entered the hearing room.]

Mr. Starrett. It is a pleasure for me to appear before this subcommittee to discuss the Defense Contract Audit Agency's role in the procurement process in the shipbuilding industry.

DCAA's mission is to perform all necessary contract audits for the Department of Defense and provide accounting and financial advisory service on contracts and subcontracts. In carrying out our mission, we perform proposal evaluations, audits of incurred costs, audits for compliance with the Truth in Negotiations Act, operations audits, audits for compliance with cost-accounting standards, and audits of claims. These functions are also performed for the other executive agencies.

With this brief understanding of our oversight responsibilities, let me address the four areas specifically mentioned in your request.

Your first area: "A general description of DCAA's oversight responsibilities with respect to monitoring the accuracy of contractor performance generally and cost data specifically."

In discharging our general oversight responsibility to monitor the contractor's performance, we review contractor operations related to financial considerations, as opposed to technical compliance with contract terms. This aspect of our work is directly related to our audits of costs.

In discharging our specific responsibilities with respect to monitoring the accuracy of a contractor's accounting cost data, we review the effectiveness of a contractor's policies, procedures, controls, and practices. The objective of these audits is to determine what reliance can be placed on the contractor's accounting system. These audits, which include test checks of transactions, are spaced throughout the year and are distributed among functions and controls considered essential to a valid accounting system.

The cost charged to Government contracts are audited by major cost distribution systems such as labor, material, and overhead.

Our audits of the labor charging system include interviewing persons at their work stations to ascertain what work is being performed, how and why they are charging their time as indicated on the labor time card. We review the time card to ascertain if it is being completed in accordance with the contractor's acceptable procedures. For instance, minimal control procedures would preclude presigning or premature completion of the card, erasures, and so forth.

The audit of material follows a similar procedure, testing the controls built into the accounting system by tracing selected material transactions.

Overhead costs are reviewed to determine their allowable, allocability, and reasonableness. This audit includes determining whether charges are properly classified as indirect, are allowable under the DAR or other contract provisions, and result from the action of a prudent business person. Our overhead audits also evaluate the basis for allocating these costs to contracts.

In addition to these compliance type audits, we have an operations audit program that is devoted to reviewing areas of a contractor's operations where we have an indication that economy and efficiency can be improved and thereby avoid excessive costs being charged to Government contracts. In other words, do it as well or better for less. Let me give you two examples of operations audits:

During one of our typical labor audits, we recommended that a shipbuilder use a different joining process on certain pipe installations. The new process requires less labor than does traditional welding and results in savings to the Government of about $100,000 per year.

During a walk-through at a tank plant, our auditors noted that a substantial amount of tank track was classified as scrap. When they investigated further, they discovered that the scrapped track had been used in testing the tank and had been replaced with new track prior to vehicle delivery. The practice was to use the track to test one tank and then scrap it. The auditors recommended that the same track be used more than once for vehicle testing. This procedure alone is expected to result in savings to DOD of about $15 million over the life of the program.

In the first 6 months of fiscal year 1983, we issued 196 of these operation audit reports which, when adopted, will avoid $105.5 million in costs chargeable to Government contracts.

Tied directly to our audit of costs is our evaluation of billing rates used to reimburse contractors as contract performance proceeds. We regularly review these rates to verify they are set low enough to insure that the Government does not reimburse the contractor for anticipated unallowable costs. We also review contractor bidding rates used in preparation of price proposals for future contracts. These rates include both labor and overhead.

Our first priority, of course, is to review contractor price proposals for new or modified contracts and provide the acquisition community with the results of our audits. We then furnish financial advisory services during the conduct of negotiations. These efforts are a significant, and we believe, a valuable part of our audit oversight of costs. These pre-award audits rely heavily on the knowledge and experience gained during our review of the contractor's historical or incurred costs.

Your second area: "DCAA's observations concerning the Ingalls Shipyard and its performance on the U.S.S. *Ticonderoga* (CG-47)."

[At this point, Senator Cohen entered the hearing room.]

Mr. STARRETT. DCAA has maintained a resident staff at the Ingalls Shipyard for many years and has issued well over 1,300 audit reports during the last 10 years. During this time, we have performed a broad variety of tasks to gain reasonable assurance that the contractor is properly charging costs to Government contracts.

Our audits involve in-depth analyses of accounting policies and procedures, costing methods, and related internal controls that provide the assurance that errors or irregularities are presented or detected on a timely basis. Many of these reports included significant recommendations. Some specific examples of the audits performed are listed below:

First: All facets of the material cycle, including requirements determination, receipt, payment, storage, issue, and transfers;

Second: Detailed reviews of both incurred and projected indirect expenses;

Third: Compliance with applicable cost accounting standards for both incurred and proposed cost;

Fourth: Economy and efficiency reviews of many segments of Ingalls' operations, including labor productivity, warehousing, maintenance and computer operations; and,

Fifth: All facets of the labor cycle, including manpower requirements, employee classification, employee utilization, timekeeping, payroll preparation, and labor cost distribution.

Regarding timekeeping, our experience indicates that the contractor's timekeeping system is functioning in accordance with its published policies and procedures. Over the past 2½ years, we have performed numerous floor check audits (approximately one floor audit per month) and have found only one instance of errors involving miscoding of time between Government and commercial contracts. While we view any labor mischarging between contracts with considerable concern, as evidenced by the amount of audit time continuously dedicated to the area of timekeeping, we do not believe that a pervasive condition of labor mischarging between contracts exists at Ingalls.

As of March 30, 1983, we have questioned $22.6 million of costs claimed by Ingalls which are currently under consideration. The cost associated with the establishment of a new yard to handle Ingalls' commercial work has been a problem. Over $100 million associated with this new yard is being allocated to all contracts during a 14-year period. We have questioned the portion of these costs allocated to Government contracts, and we are being sustained by the Navy.

With regard to Ingalls' performance on the CG-47 contract, our observations have not disclosed any significant cost problems peculiar to that program.

Your third area: "The significance to the procurement process, in DCAA's view, of its reports and reviews on contractor performance."

Our reviews and reports on the contractor's performance are extremely significant to the procurement process. DCAA is the only organization providing advice and recommendations to procurement on such things as:

First: Acceptability of costs incurred under redeterminable, incentive, and similar type contracts;

Second: Acceptability of incurred costs and estimates of costs to be incurred as represented by contractors incident to the award, negotiation, modification, change, administration, termination, or settlement of contracts;

Third: Adequacy of financial or accounting aspects of contract provisions; and,

Fourth: Adequacy of contractors' accounting and financial management systems, and adequacy of contractors' estimating procedures.

The advice provided to contracting officers in our audit reports is the basis for challenging cost claimed by contractors and is the principal input that contracting officers use in establishing contract prices and final overhead rates, among other things.

Contracting officers have the responsibility for negotiating the Government's position with defense contractors and our audit reports provide the cost advice they need to carry out this important function. We believe our work is effective, and we have received hundreds of letters that praise our auditors and comment on the contracting officers' savings achieved in negotiations.

The last area: "Your recommendations, if any, as to strengthening DCAA's audit/oversight role in the procurement process."

Our basic recommendation for strengthening DCAA's role in the procurement process would have been, "Give us more auditors," but this is now being done. We will be adding approximately 250 more auditors by the end of this fiscal year.

We have had a program for identifying areas that we believe are most susceptible to fraud. Notwithstanding my previous comments regarding Ingalls Shipyard, the labor charging area appears to be the most vulnerable. Since October 1978, we have referred a total of 165 cases to investigative agencies. Of these, 36 percent, or 59, relate to labor mischarging. The rest are distributed among other categories of irregularities.

I have been talking to this subject of labor mischarging around the country for a couple of years. My message has been that Government contractors should look to their internal controls related to labor charging to assure that they are adequate. I have also assured them that if we haven't already, we will be looking at their labor distribution systems.

The results of our efforts in this area do not show an increase in the rate of labor mischarging cases, but a continuous level of such referrals. We believe that timely and effective investigations related to these mischarging cases would send a message to the defense industry and strengthen our auditor oversight role in the procurement process.

For every dollar invested in the Defense Contract Audit Agency during fiscal year 1982, $39 were saved during negotiations. We intend to continue to emphasize our need for attending these negotiations and increase the return to the taxpayer.

Thank you again for this opportunity.

I will be happy to respond to your questions.

Chairman **Roth**. Mr. Starrett, on page 7 of your testimony, you say, "notwithstanding my previous comments regarding Ingalls Shipyard, the labor charging area appears to be most vulnerable."

Mr. **Starrett.** Yes, sir.

Chairman **Roth.** I assume you are talking broadly. That was not focused at Ingalls or Litton but the general practice?

Mr. **Starrett.** Yes; I am talking across the country.

Chairman **Roth.** How many investigations or audits have you made in different Government contractors under your jurisdiction to determine the extent of mischarging?

Mr. **Starrett.** In the audit profession, first of all, let me say that we are not holding ourselves out as an organization that can find all frauds.

Chairman **Roth.** I didn't ask that question.

Mr. **Starrett.** I understand.

Chairman **Roth.** I ask you, How many studies have you made of contractors to determine to what extent or how broad the practice of mischarging is?

Mr. **Starrett.** We have reviewed the labor distribution systems of every defense contractor that has more than $50 million of Government business within the last 2 years.

Chairman **Roth.** That, again, doesn't directly answer my question. Let me repeat my question: You make the comment here that one area that appears to be most vulnerable is mischarging?

Mr. **Starrett.** Yes, sir.

Chairman **Roth.** There is a lot of street talk that there is mischarging at some of the Government contracts. I am not focusing on any contractor. I want the record to be very clear on that. But I am concerned about the problem. And you are the principal audit agency?

Mr. **Starrett.** Yes, sir.

Chairman **Roth.** I am not asking you whether you found fraud or not. I am asking you how many investigations, broad gaged, have you made to determine the scope of this problem?

Mr. **Starrett.** I do not know how many contractors there are that have more than $50 million of Government business. But I can provide that. I just don't have that information.

Chairman **Roth.** I want you to provide me with specific information as to where and when you have made, during the last 3 years, studies of the problem of mischarging.

I want specifics.

Mr. **Starrett.** Yes, sir. The 59 cases that I referred to in my statement there lead me to believe that this is a particularly troublesome problem. The other reason that we believe it is a troublesome problem is that the labor mischarging area is one of the few areas where contractors develop the supporting documentation themselves.

For example, if you are talking about material costs, there is an invoice, there is a receipt document, there is a bill from the outside somewhere. But when you are talking about the labor charging system, the supporting documentation is developed by the contractors themselves.

So that is why we are concerned.

Chairman **Roth.** The thing that bothers me is that, in your sworn testimony, you say this is the most serious problem.

Mr. **Starrett.** Yes, sir.

Chairman **Roth.** Yet you have no information as to what your agency, your audit agency, has done in trying to discover to the extent this is a problem. It seems to me that this is a prime area responsibility of yours.

Mr. STARRETT. With all due respect, I do not know the number that you asked for but I do know what the Agency is doing.

If you would like, I will go into that.

Chairman ROTH. Let me ask you this:

What contractors do you believe, on the basis of your information, have the most serious problem in this area?

Mr. STARRETT. I would like to provide that for the record, sir, because I would have to give you contractor names, where there are investigations going on.

Chairman ROTH. I would want that information submitted within the next 2 weeks.

Mr. Starrett, I agree with you that when you say that any mischarging in this area is important. In one of the cases before us, it is my understanding where there was mischarging at the Ingalls plant where there were funds that were properly imposed on oil rigs but in fact charged against Government contracts, that initially the company asserted the cost was $20,000.

After our subcommittee investigators got involved, the matter was ultimately resolved at $137,000.

What role did DCAA play in that? What investigation did they make when this became uncovered?

Mr. STARRETT. We assisted the Navy in their part of that review. As I recall, that started from an individual who decided to advise Litton there was a problem in that area. We assisted the Navy.

Chairman ROTH. Did you make a written report?

Mr. STARRETT. No, sir. I have with me Vern Tabor, resident auditor at Ingalls.

Chairman ROTH. How long has he been the resident auditor?

Mr. STARRETT. Four-and-a-half years.

Chairman ROTH. But no written report was made?

Mr. STARRETT. Not on that particular instance; no, sir.

Chairman ROTH. Do you consider the problem of cross charging from private to public contracts a matter of high priority?

Mr. STARRETT. Yes, sir; we do. At Ingalls, we have made, as I mentioned in my statement——

Chairman ROTH. Why wouldn't that be in a written report?

Mr. STARRETT. We did not find the particular incident that you are talking about. There are times when there are whistleblowers who turn things in that we do not discover first.

Chairman ROTH. Let me point out that the initial admission was $20,000 and it wasn't until after the subcommittee became involved that there was admitted to be greater liability.

Should the contractor reimburse the Government for those funds?

Mr. STARRETT. Yes, sir.

Chairman ROTH. Have they done that?

Mr. STARRETT. Yes, they have.

Chairman ROTH. Mr. Starrett, in your testimony, you say that you did not disclose any significant cost problems peculiar to the—"with regard to Ingalls' performance on the CG-47 contract, our observations have not disclosed any significant cost problems peculiar to that program."

I cannot say all of these involve that particular contract but I note that a number of audit reports, one, June 24, 1981, that said. "Work mischarged according to preplanned schedules totally unacceptable."

August 25, 1981, "Projected over the total direct labor incurred for a year, the error rate of 7.3 has a significant impact on validity of labor distribution data used in Ingalls overall management of contract costs."

On September 28, 1981, "8.7 percent mischarge rate, we recommend that Ingalls be told to take immediate action to improve the accuracy of its timekeeping."

October 15, 1981, "Preplanned schedules found highly improper timekeeping practices, completely destroys"—this is in quotes—"completely destroys credibility of any cost data generated."

June 15, 1982, "16-percent error rate to timekeeping, Government 48 percent, with charges to commercial, 40 percent; 16 percent combined is one of the highest we have reported in any area of the shipyard."

Has your agency in recent years tried to make a broad-gaged study of mischarging at the Ingalls facility?

Mr. STARRETT. We have each year summarized the floor checks that we have made.

Chairman ROTH. How broad are those floor checks?

Mr. STARRETT. Each floor check covers approximately 60 to 70 employees and there is one a month. We have one a month, that is about 800 employees, something like that, per year. We have been doing them for a number of years. But the study or the summaries that I am talking about provide an overall picture of the mischarges and depict one that indicates, first of all, that we must consider there is a 17-digit number that is used for purposes of charging time to either commercial or Government contracts.

When you look at the period of the last 3 years and the mischarging we have found, the first few digits of the number relate to the contract, the next few digits relate to the hull, the next few digits relate to what operation it is. the next digit relates to the order and then you get to the berth, and then the station.

So, as you go down farther in this number, you find that there is a difference between what tasks are being charged on a particular contract.

When I look at the summary of our floor checks, I find that during that period of time, there were 22 mischarges between contracts. These are, for the most part, between Government contracts. My statement is specifically related to charges between contracts. I mean by that, where costs are being transferred from commercial work to Government work, that kind of thing, or vice versa. That is where you get the greatest impact on the Government, as far as the money is concerned.

At a lower level, of this 17-digit number, the recorded costs might be distorted when there is mischarging.

So there is, over this period of time, 22 instances where there were mischarges among contracts, 37 related to hulls, 15 relating to operations; keep in mind now we are going down a 17-digit number, 52 related to the order, 68 related to the berth, and 54 related to the station.

All of these things are considered in computing these error rates that we have been talking about.

I might add that, yesterday, I gather there was some testimony related to a 58-percent error rate. The report containing a 58-percent error rate represents 12 of the 22 instances I just talked about relating to mischarging between contacts.

So that although we do have error rates, looking at the reason for those error rates and what the effect of them is, I think, important.

Chairman ROTH. I would just like to say that, frankly, I am concerned about the lack of aggressiveness of your organization in the matter of audits, particularly in the matter of audits of mischarges.

This does not mean to focus on any particular contractor.

I am talking about your own operations at this stage. I do want to say that I am not satisfied. When you have got a number, when you make a general statement and say that labor is the one area most vulnerable, we have some specific audits at one facility that indicates some problems, you even make the statement such as "completely destroys credibility," I don't think the kind of check you are talking about is what I would call a comprehensive audit of a mischarging problem.

I want you to know that this is something that this subcommittee is concerned about. We are going to continue to interview and look into it. I expect that I will call upon the General Accounting Office to assist us in this study. But I am very much disturbed by the fact that you gave the impression to my investigators who came up a few weeks ago and I asked you the question, and you said to them in effect, even though you don't agree with it, this is the perception or understanding that they got, that you were concerned about your relationship with the contractor.

I want you to know that, just speaking for one Senator now, that I think your responsibility is to the Government and to the taxpayer and not your relationship to the contractor; and that we will be reviewing future practices in this area and other contractors generally.

We will call forth for further information.

Mr. STARRETT. Might I respond?

Chairman ROTH. You certainly may.

Mr. STARRETT. I believe that the statement that you are referring to, sir, 2 weeks ago or 3 weeks ago, when I was here, related to the procurement community which is the Government people that handle contract administration and buy the products.

I do not believe at that time that you said anything about contractors. Had you, I think, I would have responded differently to that question 2 or 3 weeks ago.

I would only add that not too long ago, there was a television show concerning Rockwell, where there was considerable mischarging. All of the reports that were used came from the Defense Contract Audit Agency in connection with that particular investigation.

I do not think that there is a defense contractor that will say that we are friendly.

Chairman ROTH. I agree.

Mr. STARRETT. We have a continuous problem with defense contractors.

Chairman ROTH. Senator Cochran?

Senator COCHRAN. Thank you, Mr. Chairman.

Earlier, in your testimony, you mentioned that in the course of audits at Ingalls Shipbuilding, you performed numerous floor checks and have found only one instance of errors involving miscoding of time between Government and commercial contracts. Is that correct? That is still your testimony, is it not?

Mr. STARRETT. Yes.

Senator COCHRAN. Let me ask you if that instance is reflected in an audit dated November 11, 1982, and submitted by a resident auditor, Vernon B. Tabor?

Mr. STARRETT. Yes, sir.

Senator COCHRAN. Are you familiar with that audit or do you have a copy of it in front of you?

Mr. STARRETT. I do not have a copy.

Senator COCHRAN. Let me send you a copy along with a subsequent memorandum also signed by Mr. Tabor, dated March 14, 1982.

As you probably have heard, there have been some very serious allegations made not only in the course of yesterday's hearings by one witness in particular but also by members of this committee and others through the news media about the fact that there were serious efforts by this shipbuilder to charge time to Government contracts that were actually supposed to be charged to commercial contracts.

It was also suggested that your agency, after submitting that original audit, followed up with a memorandum retreating from the position taken in the original audit. Could you comment on that for the subcommittee and state whether or not from your review of that memorandum there is any inconsistency between the findings described by the memorandum and that in the original audit?

Mr. STARRETT. I think that it might well be taken that way. But I think the reason is that in the audit report that you are referring to, we reviewed 69 people in three different sections. In one section, there were 12 people that we looked at. There were seven charging problems in that particular section which resulted in the 58-percent error rate. When you look at the seven, you find that one of them was working on commercial work and charging the Government. Two were working on Government work and charging commercial. And the other four were miscoding their time between Government cost-type contracts so that it would have little, if any, effect on the amount of money that the Government is going to pay.

[At this point, Senator Nunn entered the hearing room.]

Mr. STARRETT. So the 7 that I just explained of the 12 is the 58 percent. That is a serious problem in that section because there are very few controls in that section. We were trying to get those controls fixed in this audit report. But later on, in response to questions about the Ingalls' timekeeping system, is it fraught with problems, we were trying to put this in context. And I think we may not have done quite a reasonable job of explaining it in the memorandum. But the idea was to try to put this in context of the 10,000 employees that are charging time at Ingalls.

Senator COCHRAN. I think it is pretty clear from the memorandum which states on page 2, I think, in paragraph No. 3, that of the three persons who were mischarging between Government and private contracts, only one was performing work on an oil rig and charging the time to the Government, whereas two were performing work for the Government and charging to the oil rig. That is pretty clear. Isn't that stated in the memorandum?

Mr. STARRETT. Those are the facts as I know them.

Senator COCHRAN. Let me ask you this. Would it be an erroneous conclusion to draw from that audit in the memorandum explaining what the numbers mean in that audit that 58 percent of the work being done in that one section was being erroneously charged to the Government for work done on private contracts?

Mr. STARRETT. That is correct. That would not be a correct assumption.

Senator COCHRAN. Is there any evidence in the audits that your agency has performed at Ingalls Shipbuilding that there were any other instances of any charges for commercial work done being charged to Government contracts? This is the instance that you describe in your testimony and this is the only instance.

Mr. STARRETT. It is the only instance.

Senator COCHRAN. The fact is that in that one audit, we find not the Government being cheated by the mischarging but really more work being charged to a private commercial contract than should have been.

Mr. STARRETT. That is correct.

Senator COCHRAN. That is correct, is it not?

Mr. STARRETT. That is correct.

Senator COCHRAN. Let me ask you this: There was someone who testified yesterday about the fact that there was a type of system at Ingalls where the word is passed out to a section that an auditor is on his way, he is coming, look out. And before the auditor got out to the section, everybody would be alerted and be doing something different from what they might have ordinarily been doing.

Is that the way business is done down there?

Mr. STARRETT. No, sir. The way we conduct floor checks at Ingalls is that we select the department without anybody else knowing what area it is we are going to go to. We walk into that area, we grab the supervisor who has control of a number of employees, we do not let that supervisor out of our sight and we say to the supervisor, let's go find the people that work for you and see what it is they are working on, and what they are charging their time to. Through this procedure, you cannot get any advance notice of where it is that we are going.

I must admit that after you are looking at a number of people in a department, it is obvious that here is something going on and so somebody might pass the word. When you try to cover 60 people, you can't do it all at once. But the procedure itself does not provide for any early warning or any notice to any Ingalls people as to what area we are going to look at.

Senator COCHRAN. I also understand from your testimony that having reviewed the audits of Ingalls Shipbuilding by your agency, your conclusion is that there is not a pervasive condition of labor mischarging between contracts. Is that correct?

Mr. STARRETT. Yes, sir.

Senator COCHRAN. That is all I have, Mr. Chairman.

Thank you.

Chairman ROTH. Senator Cohen?

Senator **Cohen**. Thank you, Mr. Chairman.

Perhaps I might state at the outset since I might appear to have a conflict of interest sitting on the subcommittee and because some of my work comes from the State of Maine, I am very proud of it, but I might have some special interest in trying to heap criticism or find fault with competing. I want to make it clear at the outset that this subcommittee has been involved in a number of cases over the years going back to debarment, suspension investigations, as to why we weren't proceeding more diligently with trying to find out contractors who perpetrate some form of fraud or mismanagement upon the Federal Government.

We have investigated procurement practices. We have investigated hurry-up spending which we managed to make some reforms in that field. We have passed a bill called competition in contracting out of this subcommittee to the full Senate floor, hopefully. We have worked to find out why we have not been able to have a more uniform procurement policy. In fact, we had hearings on OFPP just last week dealing with the fact that we have been trying to get a uniform procurement policy out of our agency since 1969.

We will not have a uniform procurement policy going into effect until 1984.

So this is something I think in which this subcommittee has had a long history of trying to find out ways in which we can spend the taxpayers' money more efficiently.

I might point out that a number of us serve—Senator Stennis, Senator Nunn, myself—serve on the Armed Services Committee in which we are confronted with a problem that we are spending more and more money and getting fewer and fewer systems, fewer aircraft, fewer ships, fewer, all kinds of military equipment. We are getting less of it because the costs have been going up dramatically for a number of different reasons. But this committee hearing ought to be put in the perspective that we are trying to find out ways in which we can manage the taxpayers' money more efficiently and to eliminate practices which are taking advantage of current oversight practices on the part of the Government.

So it is in that context that I would like to, at least, proceed and perhaps raise a question that Senator Cochran just asked you. I am not sure I fully understand your answer or indeed the question. But I think Senator Cochran said, if you charge commercially for work done on a Government contract, that the only person or government that is hurt is the commercial firm. You said, yes. That isn't entirely true, is it?

Mr. **Starrett**. From a monetary standpoint.

Senator **Cohen**. Isn't it a fact that if you hold down the costs on the Government end, that becomes part of the performance record of that particular shipyard, whether it is Ingalls or Todd or BIW?

Mr. **Starrett**. That is correct.

Senator **Cohen** If part of that performance record is that you see they have met their contract, or they have come in under their contract, therefore this puts them in a better competitive position in the future, it also influences the procurement policies of the Department of Navy for the future in terms of what costs they start out in negotiating future ships?

Mr. **Starrett**. That depends on the scenario that you are in. If you are mischarging a lot from Government contracts to commercial, then the next estimate that you put together for the next contract could get you into real financial trouble because you don't have enough costs to project a reasonable price. If you are in a scenario where you are trying to get another contract as a follow-on contract, then you would be in a better position to get it, because of the lower projected costs.

Senator **Cohen**. You keep qualifying it by a lot. Does it matter whether it is a lot or a little? If you mischarge a lot, you will get in trouble. I agree with that. But suppose it is a question of several thousand dollars, hundred thousand dollars perhaps, million dollars, what ever the figure might be, to the extent that you are involved with competition when you meet a certain level of costs that you hold it under, that is influential?

Mr. **Starrett**. Yes, sir.

Senator **Cohen**. It is not just that the only person you are going to burn is the commercial side and the Government doesn't get hurt; it might get hurt.

Mr. **Starrett**. It might.

Senator **Cohen**. That is the only point I want to make and I cast no judgment on whether it occurred in this particular instance. I think what we are trying to establish is whether or not this is a practice that may be industrywide—I don't know.

If it is, it ought to be stopped. If it is, I expect the chairman of the subcommittee to bring every single yard in here—Rockwell, every single aircraft manufacturer. If cross charging is taking place on a widespread basis, then we are not doing our jobs.

Mr. **Starrett**. That is correct.

Senator **Cohen**. You would agree with that?

Mr. **Starrett**. I agree with that.

Senator **Cohen**. I go back to the cross charging. I think there was a charge yesterday at yesterday's hearings or the subcommittee staff has indicated that there was cross charging on the Aegis cruiser and costs were shifted to the destroyers. Are you familiar with that? The subcommittee staff has indicated mischarges would fall into primarily three areas: First, work performed on fixed price contracts were shifted to commercial firms. That is the one we are talking about here.

Mr. **Starrett**. Yes.

Senator **Cohen**. Second, they talked with the assignment of labor charges to available budgets without regard to jobs to the work actually performed, so-called preplanning?

Mr. **Starrett**. We did find another area.

Senator **Cohen**. The third area they talked about was planned systematic calculated charging of work performed on the *Ticonderoga* and they found two levels of management that were involved in cross charging in the field of the piping design cross charging; namely, that they were shifting costs from the Aegis over to the destroyers.

It seems to me that brings us back to the two major points. If that occurs, the Government loses, whatever yard does this. The Government is going to lose in two ways. You are going to have false historical data, No. 1, on which the future procurement depends. You would agree with that, won't you?

Mr. **Starrett**. That would be correct if the incurred costs were not properly recorded.

Senator **Cohen**. That would be a bad policy if we allowed that?

Mr. **Starrett**. Those are timekeeping errors. Yes.

Senator **Cohen**. Second, the Government might be entitled not to pay on those other ships. In other words, to the extent there are costs being incurred on destroyers for work being done on the Aegis, if that occurs, then the Government might not have to pay all those charges. It might be entitled not to pay charges on work being done on the destroyers?

Mr. **Starrett**. If it was an overrun contract.

Senator **Cohen**. If we allowed that practice, if in fact it is pervasive, it may well be, I don't know, then it is—has got to be stopped. The real question is, what does your department, the Department of Justice, this committee, do to really focus upon those activities? I recall reading somewhere where you indicated something to the effect it is about 7 percent, the amount of cross charging taking place.

Does that sound incorrect?

Mr. **Starrett**. No; I did not indicate a percentage overall anywhere.

Senator **Cohen**. I am told that one of your audits specifically used a number, March 16, 1981; the DCAA reported a 7-percent mischarge rate and labeled that to be insignificant?

Mr. **Starrett**. Yes; I am familiar with that.

Senator **Cohen**. Do you consider it to be insignificant?

Mr. **Starrett**. Again, there were 43 people involved in that particular case. The 7 percent comes from three people that mischarged their time. Looking at those three, one was working commercial work and mischarged the Government. Excuse me, one was working commercial and mischarged a commercial contract, strictly from one commercial contract to the other.

The second one was working on one hull under the CPIF 993 ship contract, and the time went to two other hulls under that contract. The third one of the 7 percent represented an individual who worked on FPIF contract 963, hull 4228, and mischarged to 5228. Looking at those three, you cannot draw, at least I can't draw any conclusion that there are major problems there. There are 3 errors out of 43. There is a 7-percent error rate. There is no question about it. But when you are talking about 15 to 17 digits in time charging numbers, there is going to be an error rate.

Senator **Cohen**. Have you made any special effort in the field of followup on the enforcement side? In other words, you find misreporting or the mismatching of records, of work actually performed. What do you do? Do you report that to your chief office? Do you report it to the Department of Navy? What do you do to follow up to see to it that those corrections are taken?

Mr. **Starrett**. If I might, let me refer back to the first part of your previous question to talk about labor for a moment. We, as I said, are concerned about labor distribution systems. There are many ways of evaluating labor. We are making analyses in our field offices of the trends in labor charges. For example, there are instances where charges are going consistently to accounts related to IR&D advanced agreements. When the costs get close to the ceiling in these agreements, all of a sudden there are no more charges being charged to these accounts. When we find these things, we then go out and we look at that Department and we see what the people are working on and if they are still working on IR&D—independent research and development—then we write that up and refer it immediately to an investigative organization.

That is an example of a trend-type analysis in the labor area that gives us information related to where we ought to spend our resources. We are an agency that does analyses for the purpose of finding vulnerable areas. We then direct our resources to these areas because to audit every transaction would take an exorbitant amount of auditors. No one could afford it. In addition to making trend analyses and going into areas that look like they are suspicious, we also do what we refer to as intensive labor audits. We have been under considerable criticism from the defense industry because we have developed questionnaires that we use in making these audits. They are kind of extended floor checks, I guess you might say. We want to not only look at what is going on today and make sure that the time is being charged correctly but also find out from the individual what they were working on last week, and then find out since that is already recorded, whether or not it was recorded correctly.

Through these types of reviews, we have identified 59 cases that we have referred for investigative effort. This is over a period from October 1978 to the present. Those 59 cases have resulted in 3 or 4 convictions, I believe. One of them was settled out of court—actually not a conviction.

Senator COHEN. Let me just point out that, according to the material I have been looking at, you had a situation where there was mischarging of work according to preplanned schedules and that you found that practice in 1981 to be highly improper as a timekeeping practice which completely destroys the credibility of the cost data generated. Then the same practice was in 1982. What you received was a promise from the yard to stop that particular practice.

Mr. STARRETT. These continuous reviews are testing that.

Senator COHEN. I think you ought to be more vigorous. Once you discover that, we ought to be more vigorous in seeing to it that the procedure stops.

Mr. STARRETT. In 1981, we decided that what was happening was there were employees that were classified as direct employees that had numerous tasks going across their work station. It was very difficult for them to keep track of each contract and each charge. In effect, what these people really should have been doing was charging an indirect account and spreading the cost to the overall work because they really didn't meet the accounting requirements for being direct employees. We recommended in 1981 that Ingalls reclassify approximately 500 employees from direct to indirect. I believe 470-some were reclassified. That helps to reduce mischarging because if you have too many things going across your work station, you can't keep track of what contracts you are working on. Therefore, you should really be an indirect employee.

Senator COHEN. I think we are going to hear from the Department of Justice later and in terms of our enforcement practices and, frankly, I don't know enough about the facts in that case but it seems to me, as

I recall reading, there was a criminal complaint brought in, I believe, 1976, and nothing was done. The court finally dismissed it, showing there was absolutely no intent on the Department of Justice to go forward. Either the complaint or the indictment never should have been brought or it should have been prosecuted. But to simply allow things to draw and continue business as usual, no matter what, whether it is Rockwell or anybody involved, we are going to lose credibility in terms I supect in our defense industry in its entirety.

People simply believe there is a lot of waste and mismanagement involved. Frankly, we find there is a lot of waste and mismanagement. I won't go into the sorry story today, but I can point to a number of systems in various categories of weapon systems development where we are way over the budget. Much of it is due to mismanagement. It is getting very hard to go back and explain to people why you are cutting out health benefits and putting caps on insurance programs, and yet we simply come up with a bill to pay for the mismanagement of programs in the Defense Department.

That is all I have, Mr. Chairman.

Chairman ROTH. Senator Nunn?

Senator NUNN. Thank you, Mr. Chairman.

Just a couple of questions on the overall type contract we are dealing with.

We are dealing with contracts essentially that allow the contractor to pass through the cost; is that right?

Mr. STARRETT. Yes, the cost-plus award fee contract.

Senator NUNN. The contractor—there used to be an old type contract that was abolished by California, that was cost-plus percentage of cost. In other words, the more it cost, the more profit you made. We don't have those kinds of animals running around anymore, do we?

Mr. STARRETT. I hope not. Not that I know of.

Senator NUNN. But you don't have a firm fixed contract here; is that right?

Mr. STARRETT. Not a firm-fixed price contract. This is a cost-type contract where costs incurred will be paid by the Government, assuming that they are reasonable and in accordance with the terms of the contract.

Senator NUNN. What is the incentive of this contractor in this type of contract to hold down cost? They get a percentage of what they save? What is the incentive?

Mr. STARRETT. For this particular type of contract, the incentive is in the award fee area, how you go about establishing that, the determination of whether or not they were efficient, and what percentage of the fee relates to cost savings are all questions that relate to this incentive.

That is a procedure that I believe the Navy could probably speak to better than I can, sir.

Senator NUNN. In looking at that, your overall job is to look at the compliance for the contract; right?

Mr. STARRETT. We are looking at the costs charged to the contract, whether or not they are in accordance with the contract terms.

Senator Nunn. Your people get some idea about whether there is really an incentive in this type of contract to hold down the contract costs, don't you?

Mr. Starrett. Yes.

Senator Nunn. Do you believe the contractor, not just this one, but talking about this type of contract, do you think the contractor really does have an incentive to hold down the cost?

Mr. Starrett. Under cost-type contracts, the incentive is not nearly as great as it is in firm-fixed price contracts. No question about it.

Senator Nunn. Do you have any suggestion, your own personal views? I am not asking for the Defense Department views or OMB or Joint Chiefs or the Secretary of the Navy, just your personal view now as to when there would be ways to build in the contract a greater incentive for the contractor to actually hold down costs.

Mr. Starrett. Yes, sir. I think there are many, many times when defense contractors could invest in more efficient equipment, better state-of-the-art type of manufacturing processes and things like this, if there were proper incentives.

Senator Nunn. Personal opinion, that is what I am asking for.

Mr. Starrett. If we could incorporate clauses in the contract that would provide for sharing in the profits; the efficiencies that are achieved over the years by use of better equipment, by use of high technology-type of approaches, by robots, or computer-aided design equipment, we could all save money from these things.

Senator Nunn. You are saying that the current contracts don't have those kind of systems?

Mr. Starrett. Not a cost-type contract. You would not have an incentive to go out and invest your money in these types of things.

Senator Nunn. Supposedly, theoretically, isn't there a sharing agreement, you come under cost, let's say you anticipated a cost at $100, hypothetically, you end up spending $80, instead of $100, that $20 difference; isn't there a sharing arrangement between the contractor and the Government on that $20 cost saving?

Mr. Starrett. There are various types of cost-type contracts. One is a CPFF, cost plus fixed fee. Under this type of contract you negotiate at the beginning the fee the contractor is going to get for the performance. It does not vary.

Then there is a cost-plus incentive fee contract which is what you are talking about which provides for sharing of costs if they come in below a target.

Senator Nunn. Sharing of savings?

Mr. Starrett. Sharing of savings or overrun.

Senator Nunn. I thought that is what we were dealing with in these shipbuilding contracts?

Mr. Starrett. Similar to that, except it is an award fee, meaning there is a meeting, get together, you decide what it is that is going to be provided in the way of a fee as opposed to an incentive, CPIF, where it is laid out in the contract and you don't have to have a meeting. You look at the contract, and if the costs are such and such, then you will share $80–$20, for example.

Senator Nunn. Tell us then what, in your view, could be done to give great incentive; then, for instance, compare your own personal view about what could be done in these contracts with what actually has been done—let's say, these shipbuilding contracts we are talking about now?

Mr. STARRETT. I think we could develop clauses which talk about certain targets or manufacturing costs. Then, assuming we believe there are a number of improvements that can be made in the way the item is being produced, we tell the company, in these clauses, we will share with you below that target 50/50 or whatever a good incentive might be.

But it would have to be specifically laid out as to what the target manufacturing costs are, then you would have a benchmark to work from after that.

Senator NUNN. You are saying that there is no incentive for the company to take a front end capital outlay that would later on recoup costs?

Mr. STARRETT. That is correct. No incentive under cost-type contracts.

Senator NUNN. Is there an incentive to hold down labor costs?

Mr. STARRETT. I think the award fee is the incentive in this case.

Senator NUNN. Is that sufficient? Does that really give the shipbuilder the incentive to cut labor costs anywhere they can be cut?

Mr. STARRETT. I don't know how to respond to that because I have not looked at this particular contractor's program for investing or what efforts are really being made.

Senator NUNN. Let's say your general view, do we have sufficient incentives in these shipbuilding contracts normally to give the contractor incentive to really save labor?

Mr. STARRETT. In my view, the cost-type contract, even if it is an award fee-type contract, does not usually provide enough incentive.

As a matter of fact, the Department of Defense is currently working on different ways to do just about what it is that I have been talking about. There is a committee, a group that has been set up and, as I recall, the head of this particular committee is Admiral Sansone, and he is working on more or less the same thing that we are talking about, how to go about giving contractors incentives so that they will invest in equipment that is much more efficient and productive.

Senator NUNN. That has been talked about for 30 years in Government. Why it is we cannot even seem to arrive at this kind of arrangement? Of course, I guess we went to the fixed-fee contract, or the bid-type contract, and then we had so many clauses in there related to changing inflation and so forth, that is where we got into the overrun problem, wasn't it?

Mr. STARRETT. Yes. Another thing that must be considered is the type of work that is involved. If it is really pushing the state of the art, research-type effort, something like that, we really could not firm-fix price that.

Senator NUNN. That would apply to the first of the class of ships, it seems to me.

Why should it apply to the third, fourth, fifth, sixth, seventh?

Mr. STARRETT. After the design is fairly stable and you know what it is that you are buying, in my opinion, firm-fixed price would be the way to go.

Senator NUNN. Don't we have here a situation where seven ships are being built, all of them on this cost-passthrough kind of arrangement?

Isn't that the case with the ships being built of the class that we have been investigating here?

Mr. STARRETT. Yes, sir.

Senator NUNN. Do you know a reason for that? Doesn't it seem to you to be reasonable that, after the first one or two, that there would be enough experience where there could be a firm bid on it?

Mr. STARRETT. Without knowing the status of the design and whether or not they are going to be exactly the same types of ships, I couldn't really respond to your question.

Senator NUNN. We will ask the Navy that. But let's say from your point of view, on the firm-fixed bid, you don't have to worry about the labor costs and all of the accounting; you turn in the sheets and so forth, would you?

Mr. STARRETT. Under firm-fixed-price contracts, we don't even have access to records.

Senator NUNN. Wouldn't the same thing apply to energy investment that you just mentioned a minute ago, if there were an outlay of $10 million that a contractor needed to make in order to save $500,000 or $1 million a year, something of that nature, is there any incentive in these contracts for the contractor to invest in that kind of thing?

Mr. STARRETT. Not normally in a cost-type contract.

Senator NUNN. What about your people? How many folks do you have in your areas?

Mr. STARRETT. We have 3,500 in total; we will be going to about 3,748 by the end of this year.

Senator NUNN. How many of those are trained professional auditors?

Mr. STARRETT. There are 3,000 trained professional auditors, 675 are certified public accountants.

Senator NUNN. How many of these have training in the criminal investigative area?

Mr. STARRETT. None.

Senator NUNN. Zero?

Mr. STARRETT. Zero.

Senator NUNN. Doesn't it seem to you, in all of this area, that you are sort of the frontline investigator and that you ought to have some criminal investigators so that you would recognize a criminal case when you stumble across it?

Mr. STARRETT. I believe that the Department of Justice might want to speak to this later but the problem is that information fathered in the normal course of audits might be flowing over into an investigation. This has legal ramifications and creates a problem in that you could be accused of doing something that is being used for another reason.

Therefore, it is very important to keep the audit function separate. When we find something that looks like it is criminal or is illegal or just irregular, even we will immediately refer it to an investigative organization and, then, they set up a case, they do the investigation.

Senator NUNN. It seems to me it would require at least a modicum of criminal investigative experience in your whole staff of 3,500 to be able to properly recognize those schemes involving white-collar crime and computer crime in these areas. It takes sophisticated people trained to some degree in criminal audit work to be able to even recognize it when they run across it. At least that is what I have been told by all the professionals in this area. It seems to me you would want some people out of the 3,500 that have this kind of background?

Mr. STARRETT. I guess it would certainly be helpful. The agency does have a number of programs, though, that are designed to make the auditor aware of the types of situations that should be referred for investigation. We have summarized, for example, the cases we have referred for investigation and disseminated this summary to all the field auditors so they could see what it is we are talking about.

We also have a course at our institute in Memphis which provides an awareness program for auditors to make sure that they are aware of the types of things that should be referred.

Senator NUNN. Your referral rate of overall investigations in the amount that you refer for criminal investigations, according to the staff report, which is very, very low.

Have you already commented on that?

Mr. STARRETT. No. I have not. But I would like to. I noticed in a staff report there was a percentage computation of the number of referrals——

Senator NUNN. I think it was——

Mr. STARRETT [continuing]. Per year to the total number of audit reports that are issued and then there is a comparison of that with the GSA [General Services Administration].

Senator NUNN. 800, this is percent, and 3.3 in GSA. This committee has been involved in GSA a lot of times. There is a lot of reason for referral there.

Mr. STARRETT. There is another factor I think must be taken into consideration; that is, the contract administration organization in the Department of Defense is a separate organization, and there are a number of instances of irregularities that relate to substituting material for a lower class material in the product than is called for in the contract, fraud related to delivery, et cetera.

These are all contract administration type referrals. These people refer that type of thing. I think you have to add all of those statistics with the defense contract audit agencies statistics in order to be able to compare it with the GSA.

Senator NUNN. What is that outfit called?

Mr. STARRETT. Defense Contract Administration Services working for the Defense Logistics Agency.

Senator NUNN. That is separate from yourself?

Mr. STARRETT. Yes.

Senator NUNN. Would you compile those, add them together, compute a percentage, and furnish it for the record?

Mr. STARRETT. Yes.

Senator NUNN. If you add that, do you think you would have apples and apples?

Mr. STARRETT. We hope not to be compared to GSA.

[The information requested and subsequently received by the subcommittee follows:]

The Defense Contract Administrative Services referred 198 cases to investigative organizations during the year ending September 30, 1982. Since they do not issue audit reports, the base number used by BGA of 60,000 audit reports is not increased. The resulting referral rate is 0.4 percent. However, half of the 60,000 reports issued by DCAA each year pertain to evaluations of pricing proposals. This type of audit is not a routine audit function under the advertised procurement procedures of GSA.

Chairman ROTH. Senator Stennis?

Senator NUNN. May I ask one other question?

What other resources do you need if any to do the type of job that you believe your agency is charged under the law and regulations with doing?

Mr. STARRETT. Like I mentioned before, we have recently received an increase in the amount of money that allows us to go to 3,740 people.

Senator NUNN. Is that enough?

Mr. STARRETT. No, sir. We are still working on increasing it more than that.

Senator NUNN. How many more do you need? What would be optimum?

Mr. STARRETT. The last time that we looked at our requirements they were a little over 4,000.

Senator NUNN. Why does OMB resist that? You say you get a $39 return for every dollar invested in your agency last year. Is that right?

Mr. STARRETT. This is not OMB. I don't mean to portray this as an unusual problem. We are going through the process of getting those spaces. I don't really anticipate a problem.

Senator NUNN. Is it right that you have a $39 return for every dollar invested?

Mr. STARRETT. Yes.

Senator NUNN. How do you compute that?

Mr. STARRETT. We compute that in a very conservative way. When we were talking about cost-type contracts, for example, and we are looking at a proposal; we might question $100,000 in the subcontract area that is sustained in negotiations the only thing that goes into the savings computation is the amount of fee on that $100,000, probably be anywhere from 7 to 10 percent. So we do not put the $100,000 in the net savings number. It is therefore conservative because of the type of contract involved and the way we compute it. No. 2, it is conservative because there isn't anything in it for the preventative nature of audit; the fact we are there and we are looking and the contractors frequently will not do something they might otherwise do if we were not there.

In addition, the $39 is supported by documents that go back to negotiation memos and so forth, and it is a solid number. It is not only solid, but it represents 60 percent of the total dollar savings that are reported by the President's Council on Efficiency and Integrity to the President.

Senator NUNN. If we had more firm fixed-price contracts and more competition and less change orders, less cost pass-through contracts, you wouldn't need as many people?

Mr. STARRETT. That is correct.

Senator Nunn. Competition, supply and demand would take care of a lot of it?

Mr. Starrett. Yes.

Senator Nunn. Thank you, Mr. Chairman.

Chairman Roth. Thank you, Senator Nunn.

Mr. Weiland?

Mr. Weiland. Just for the record, Mr. Chairman, I think it is worth making a couple of points and perhaps Mr. Starrett would like to respond. You mentioned in your statement that you found only one instance of cross charging between Government and private sector contracts. Is that right?

Mr. Starrett. That is right.

Mr. Weiland. I believe that audit report is dated November 11, 1982. I think it should be pointed out that that did not, Mr. Chairman, deal with the major oil rig case, the SITA case which was a completely different cost center in which the company eventually settled for $137,000. Is that right, sir?

Mr. Starrett. The report did not deal with that case. No, sir.

Mr. Weiland. The events were transpiring at approximately the same time. Is that right?

Mr. Tabor. The CDI was transpiring about some time in 1981. Our floor check dealt with 1982.

Mr. Starrett. June of 1982.

Mr. Weiland. The point that I think is worth making is that you are not representing that all of the cross charging to commercial contracts and Government contracts have been discovered by your auditors?

Mr. Starrett. No. I am not making that point.

Mr. Weiland. The only other thing, Mr. Chairman, has to do with a June 1981 DCAA audit which included a visit to cost center 555 which was the piping engineering department and which failed to detect a cross charging problem there. We had testimony yesterday and extensive witness interviews which indicated that that was the approximate time of the massive amount of movement of charges between the destroyers and the cruiser, CG-47. The point being that there has been evidence that DCAA auditors have been able to be deceived and perhaps that was what happened with respect to that particular audit.

I might add that the audit report indicates that it was provided to Ingalls on June 16, 1981 and as of the date of the report they had not received a response and the report was dated October 13, 1981.

Chairman Roth. Thank you, Mr. Weiland.

[Correspondence containing questions from Senator Roth to Mr. Charles O. Starrett and his response thereto, received subsequent to the hearings follows:]

U.S. Senate,
Committee on Governmental Affairs,
Senate Permanent Subcommittee on Investigations,
Washington, D.C., May 6, 1983.

Mr. Charles O. Starrett, Jr.,
Director, Defense Contract Audit Agency, Cameron Station, Alexandria, Va.

Dear Mr. Starrett: On behalf of the Subcommittee, I wish to thank you for providing testimony before PSI on timekeeping practices at Navy Shipbuilding facilities.

As I stated, the hearing record would be left open so that we could obtain responses to questions which, due to the press of business, were not asked of the witnesses on May 4. Additionally, please provide all DCAA studies or reports upon which you based your statement at the hearing that labor mischarging is a pervasive problem with defense contractors.

Please provide complete responses to the following questions. Where necessary, I have indicated those areas in which I would like you to refer to DCAA's on-site audit work at the Ingalls Shipyard.

1. When DCAA auditors come across the very same situations as were described by PSI staff at the hearing, which they have over the last few years at Ingalls, why doesn't DCAA usually assess the cost of such mischarging, be it between Navy contracts or between Navy/commercial contracts?

2. Would you agree that even a seemingly low mischarge rate at a larger shipbuilder would amount to many millions of dollars each year?

3. We have seen that managerial distribution to Ingalls' employees of preplanned charging directives has been discovered by DCAA, by Ingalls internal auditors, and by PSI. Yet, DCAA has never evaluated how this practice effects the integrity and accuracy of the contractor's cost data. Is it possible these accounting problems could have an effect on Ingalls pricing proposals and post-award defective pricing reviews?

4. Was any special report of timecharging problems at Ingalls ever sent to DCAA Headquarters? If so, what actions has DCAA Headquarters taken to notify Navy procurement officials and to ensure that corrective action is taken?

5. What is the role of DCAA in assuring that the proper government contracts are charged, and all monies owed the government are recouped, when mischarging is discovered?

Should you have any questions about this request please do not hesitate to contact Karen Hainer, Staff Investigator, at 224-3721.

I look forward to receiving your response by May 20, 1983 so that it can be included in the hearing record.

Sincerely,

William V. Roth, Jr.,
Chairman.

Defense Contract Audit Agency,
Alexandria, Va., June 3, 1983.

Hon. William V. Roth, Jr.,
Chairman, Senate Committee on Governmental Affairs,
Senate Hart Building,
Washington, D.C.

Dear Chairman Roth: During my testimony before your committee on 4 May 1983, you requested information on the number of labor investigations (audits) performed by the Defense Contract Audit Agency (DCAA) at major defense contractor locations during a 3-year period and the names of major defense contractors that I believe have the most serious labor charging problems. The following are replies to your inquiries.

1. Where and when DCAA has made, during the last three years, studies of the problem of mischarging?

There are approximately 260 major defense contractors audited by DCAA besides thousands of smaller ones. At major contractor locations one assignment is opened at the beginning of the year and entered in our Management Information System (MIS) for accomplishing floor checks. Numerous floor checks are accomplished, resulting in audit reports being issued during the year, but our MIS does not identify each one. Conservatively estimating one floor check a month, there would be over 3,000 a year at major contractor locations. In addition, each year we have accomplished 600 other audits at major contractor locations specifically related to labor costs. These numbers do not include audits of contract pricing proposals (82,500 during 80, 81, and 82), overhead costs (3,500 during 80, 81, and 82), and operations audits (1,600 during 80, 81, and 82) during which various aspects of labor costs are reviewed along with other elements of cost at major and smaller contractor locations.

2. What contractors do you believe, on the basis of your information, have the most serious problem in this area (labor mischarging)?

The names of major defense contractors with serious labor charging problems have been referred by DCAA for investigation of labor charging practices. A list of these contractors has been submitted to the Department of Justice for clearance. I will send you what material I can as soon as I hear from that office.

Sincerely,

C. O. STARRETT, Jr.,
Director.

DEFENSE CONTRACT AUDIT AGENCY,
Alexandria, Va., May 27, 1983.

Hon. WILLIAM V. ROTH, Jr.,
Chairman, Senate Committee on Governmental Affairs,
Senate Hart Building,
Washington, D.C.

DEAR CHAIRMAN ROTH: In response to your letter of 6 May 1983, let me begin by saying that labor charging procedures represent a most vulnerable area. I do not recall, however, saying that "labor mischarging is a pervasive problem with defense contractors." The basis for my concern is not contained in any study or report, but rather, from a general knowledge of trend data. During the period from 1 October 1978 through 31 March 1983, a total of 59 instances of suspected fraudulent labor charging representing over $20 million were referred for investigation. DCAA has instituted an intensified labor audit program which is being accomplished at high risk contractor locations. The cost question in labor audits increased by $22 million from 1981 to 1982. We are continuing our efforts in this area, and we have formed special regional teams that are concentrating on labor audits.

The following are replies to the five specific questions raised in your letter:

1. "When DCAA auditors come across the very same situations as were described by PSI staff at the hearing, which they have over the last few years at Ingalls, why doesn't DCAA usually assess the cost of such mischarging, be it between Navy contracts or between Navy/commercial contracts?"

It is DCAA's policy to quantify the impact of all audit findings in audit reports when it is determined appropriate and meaningful. We do, however, make sure the contractor's records are corrected and oversee appropriate billing adjustments.

The primary audit objective in the review of defense contractors' timekeeping procedures include (i) an evaluation of the adequacy and effectiveness of the contractor's internal control procedures to insure the reliability of employee time records; and (ii) physical observations (floor checks) of work areas to determine that employees are actually at work, they are performing in the assigned job classification, and that the time is charged to the appropriate job.

There are several criteria used to determine the necessity or validity of quantifying labor mischarging deficiencies disclosed in a review of defense contractors' timekeeping procedures. These criteria include (i) the significance of the labor mischarge rate; (ii) the validity of projecting labor mischarging rates either department-wide or plant-wide; and (iii) whether the labor mischarges represent a pervasive systematic scheme or isolated instances. Depending on the specific circumstances surrounding a labor mischarging situation, an informed decision is made using the above criteria as to whether the labor mischarging deficiencies are to be cost impacted.

2. "Would you agree that even a seemingly low mischarge rate at a larger shipbuilder would amount to many millions of dollars each year?"

Yes it could, if direct labor charges are $200 million a year, a rate of 5 percent could result in a $10 million labor mischarge. The cost to the Government; however, would depend on whether the mischarging was between commercial and Government contracts.

3. "We have seen that managerial distribution to Ingalls' employees of preplanned charging directives has been discovered by DCAA, by Ingalls internal auditors, and by PSI. Yet, DCAA has never evaluated how this practice effects the integrity and accuracy of the contractor's cost data. It is possible these accounting problems could have an effect on Ingalls' pricing proposals and post-award defective pricing reviews?"

By way of background, for several years prior to the contractor's entry into the commercial oil rig business, the contractor's efforts were totally directed to Government flexibly priced business. During that time, the DCAA staff placed greater emphasis on efficiency and economy (cost reasonableness) type audits than financial/attest and cost allocability type audits. As commercial work increased, we recognized the Government would be more vulnerable to possible cost mischarging as a result of concurrent commercial and Government business, and accordingly, programed for greater effort in the financial/attest and cost allocability areas.

With the change to a mixed work environment, commercial and Government, we felt that labor would be the area of highest vulnerability for several reasons. First, unlike material and costs for other services, source documentation for labor is developed solely by the contractor. There is no external documentation for validation of charges as with material cost. Second, for the most part, we felt there would be little commonality between material required for a commercial oil rig as opposed to the material required for a sophisticated Government ship. Further, we decided that within the labor area, the program/engineering (white collar) areas presented the highest vulnerability to mischarging. Accordingly, we directed our efforts to the proper labor classification of white collar personnel and also directed floor checks to that area.

As a result of our efforts, we found significant problems with the classification of personnel, a condition which presented this type contractor personnel with too much flexibility for assigning time. We recommended changes which resulted in the contractor reclassifying some 475 personnel from direct to indirect.

In another case, we found personnel were recording their time weekly, not daily. We recommended, and the contractor agreed, to require these personnel to record their time daily.

As additional perspective regarding our reported floor check findings and more to the specific point of the question, the DCAA resident staff at Ingalls has not found the use of preplanning charging guidance to be a widespread or recurring problem, and we do not believe it is accurate to characterize this as a "practice." Floor checks performed in recent years have noted only two instances where time charging guidelines were being used. In both cases, the conditions were investigated to the extent necessary to determine that there was no adverse impact on cost to the Government. In general, miscoding of time between contracts, regardless of whether a preplanned guidance was used, has not been found to be a significant problem. During a 2-year period, aside from the incident covered in a November 1982 report, nine instances (out of 1,441 persons interviewed) of miscoding time between contracts have been found. Furthermore, none of these miscodings were between Government and commercial contracts. In fact, the majority of time charging errors found at Ingalls occurred at a lower level (tasks within a contract) and simply indicated the need to improve the accuracy of time assignment to the more than 20,000 work packages required during the construction cycle of each ship. While errors of this type have been reported over time because some may impact the detailed accumulation of labor costs within specific contracts, errors at this level have no impact on amounts billed to the Government for any particular contract. These errors are not considered to have any significant impact on proposals based on incurred cost data. One field designates the numerical sequence and type of work package, while the other designates the geographical area where the work is to be performed. Accordingly, neither of these fields enter into the estimating process nor, consequently, directly affect the potential for defective pricing.

4. "Was any special report of time charging problems at Ingalls ever sent to DCAA Headquarters? If so, what actions has DCAA Headquarters taken to notify Navy procurement officials and to ensure that corrective action is taken?"

No special report dealing with labor timekeeping at Ingalls has been sent to the attention of DCAA Headquarters.

5. "What is the role of DCAA in assuring that the proper government contracts are charged, and all monies owed the government are recouped, when mischarging is discovered?"

The role of DCAA is to audit, examine, and/or review contractors' and subcontractors' accounts, records, documents, and other evidence; systems of internal control; accounting, costing, and general business practices and procedures; to the extent considered necessary in our professional judgment. We then approve vouchers for payment (less contract costs suspended and/or disapproved) under cost type contracts, and advise contracting officers on the acceptability of cost incurred under redetermination, incentive, and similar types of contracts. Recoupment is accomplished through these procedures.

C. O. STARRETT, Jr.,
Director.

Chairman Roth. At this time, we will call forward the Assistant Secretary of the Navy, George Sawyer; Vice Adm. E. B, Fowler, and Rear Adm. Wayne Meyer.

Gentlemen, if you will remain standing and raise your right hands, do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. Sawyer. I do.

Admiral Fowler. I do.

Admiral Meyer. I do.

Chairman Roth. Please be seated.

We welcome you here, Secretary Sawyer. We would ask you to identify your colleagues and then, if you could summarize your statement in the interest of conserving time, we would appreciate it.

Mr. Sawyer. Sir, I would be most pleased to.

Chairman Roth. Your actual full statement, of course, will be included.[1]

TESTIMONY OF HON. GEORGE SAWYER, ASSISTANT SECRETARY OF THE NAVY; VICE ADM. E. B. FOWLER; AND REAR ADM. WAYNE MEYER

Mr. Sawyer. Very fine. In view of the comments and the testimony, questions, and answers of the last witness, I would like to amplify my prepared testimony, particularly with emphasis on contract types, both in terms of this award and in the general context of Navy shipbuilding at the present.

It is true that Ingalls is presently performing under three contracts of the cost-plus-award-fee type for construction of *Ticonderoga*-class cruisers. I want to emphasize that this is a relatively new type of contract for Navy shipbuilding. It was proposed as a result of a number of the Navy shipbuilding improvement studies that were undertaken in the late 1970's, largely on the basis of the major claims which occurred during that decade.

Basically, our policy is to use this type of contract in the developmental and initial production days of the program, where the scope of work definition is not precise, and where technical and management performance by the contractor is of paramount consideration. There is always a question of tension between cost capability and performance. There is no ideal type of contract type. We all must recognize that. But in those cases where the scope of work is really not well known, and where we have a highly complex major program of the type that the *Ticonderoga*-class, or Aegis, cruiser represents, I believe the selection of a cost-plus-award-fee contract is most appropriate.

It is the policy of this administration to change to fixed price incentive contracts as soon as the program stabilizes and the scope does become better known and return costs are available. Moreover, it is our policy to resort to competition on the basis of fixed price incentive contracts wherever possible. I think it is important to recognize that we have been moving very strongly in that direction. Over 60 percent of the contracts that will be awarded on the basis of the fiscal year 1984 SCN program submitted to the Congress will be awarded competitively on the basis of price.

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[1] See p. 255 for the prepared statement of Hon. George Sawyer.

Indeed, with this cruiser item——

Senator NUNN. Sixty percent of what?

Mr. SAWYER. By dollar volume, 60 percent of the total SCN line in the fiscal year 1984 program proposed to you will be competitively awarded on the basis of price.

Senator NUNN. Sixty percent of shipbuilding?

Mr. SAWYER. Yes.

Chairman ROTH. Fixed price?

Mr. SAWYER. Fixed price incentive. We have two different types of fixed price contracts: firm fixed price and fixed price incentive. The fixed price incentive is a fixed price type contract which has a share line; generally, we try to negotiate a steep share line whereby there is participation or sharing between the contractor and Government in terms of both underrunning and overrunning the target costs.

Chairman ROTH. Could I interrupt for clarification? How will that kind of sharing be administered? Who will be responsible for analyzing the savings?

Mr. SAWYER. Unlike the cost-plus-type contract, where there is a judgmental or subjective element with regard to what the fee is, a fixed price incentive contract with a share line is all predetermined in the contract. It is whatever the return costs to the project are.

Chairman ROTH. It is just a pre-agreement?

Mr. SAWYER. Yes. I think it is important to recognize that the Aegis cruiser is a program in which we established a second source last year. We brought in a potential competitor to Ingalls; namely, Bath Iron Works. This was the reason that we continued the cost-plus-award-fee type contract for 1 more year with Ingalls than, frankly, I would normally have wanted. The first contract with Bath Iron Works is a cost-plus-award-fee type contract. In the 1984 program next year, the two shipyards will compete on the basis of price, assuming the three cruisers in the fiscal year 1984 program are authorized and appropriated by the Congress.

In my prepared testimony, there is quite a bit of discussion on how a cost-plus-award-fee contract is administered. It is a subject I have discussed with regard to determining the large fraction of the fee that is given to the contractor, what we call the award fee pool. There is a small fraction of the fee, usually around 3 percent or less, which is fixed. The award fee is based on different factors. In the case of the Aegis cruiser program, the factors are technical, management, schedule, and costs. It is true that in the case of the first ship, which is the prototype of the *Ticonderoga*-class, cost was not one of the more significant factors; the weighting was 15 percent. In the subsequent contracts, cost is now the major criterion in determining the award fee.

Senator NUNN. If I could interrupt just a minute, Mr. Chairman, do you think even in that first contract, that costs should have been relegated down to the 15-percent factor?

Mr. SAWYER. In my personal opinion, yes, sir. Recognizing the complexity of the program, I think that the strong weighting on technical management in this particular case—you have to understand the complexity of the Aegis cruiser—was probably well placed. This requires the strongest type of contract administration on the part of both the program management organization and the supervisor of shipbuilding. But I think it is important to note that the *Ticonderoga* did deliver ahead of schedule and within 3 percent of the original budget. I think that is a record that is quite excellent for a lead ship program, even if it had been awarded on a fixed price incentive type contract basis. In many cases, within that budget, you cover the share line under a fixed price incentive. So I would say that Ingalls' performance on this contract was really quite remarkable.

Senator Nunn. Overall, do you think it was well done?

Mr. Sawyer. Yes, sir. We are not making any apology with regard to the overall program. I think it is also very important to put certain things into perspective with regard to contract administration and time charging. I can't agree more with the sentiments of this subcommittee that any hours mischarged or any amount of wrongdoing, whether inadvertent or deliberate, is something that cannot be tolerated. Let us understand the magnitude of the program itself that we are talking about.

Senator Nunn. Mr. Chairman, may I ask one question here. I am going to have to leave and come back.

I understand the nature of the difference in the first ship and the second ship and third ship and fourth ship. It is my understanding that four ships went to Ingalls on this same type cost-plus-fee-award contract. How do you explain four ships rather than just the lead ship?

Mr. Sawyer. Personally, Senator, I would explain it two ways. The First gets into the gray areas of judgment. We are talking about a very complex ship, one in which several of the follow-on ships have had some major changes incorporated. For example, incorporation of the vertical launch system, the LAMPS–III, and other changes will significantly impact on the scope of the contract, in terms of the engineering and definition of design, and later in terms of construction. So from the technical standpoint, I would put it on a judgmental basis.

The second, and the more significant point was bringing in a second source, and the desirability of getting both shipyards geared up from the standpoint of head-to-head competition during the balance of the program. I felt that it was just as wise to continue, particularly since the overall performance of the shipyard in terms of budget was really quite good. If we had seen signs that there was a significant overrun to the budget in the cost-plus nature of the work, we probably would have changed sooner.

Senator Nunn. Couldn't you change? Even if you have one, the lead ship is not the exact same ship as the second, it seems to me by the time you get two of those ships built that any kind of changes in the third and fourth version could have been handled with some separate contract provision. It looks like to me you just are going on too long on this type of contract, when I think everybody that is dealing with the raw economics would realize that this cost passthrough ought to be terminated as soon as possible.

Mr. Sawyer. Actually, if we were in the process of competing the program, then going over to the fixed-price-type contract would provide major cost savings. You have to understand that Ingalls shipyard was still in a sole-source position, and there were many changes to the scope of the work still planned for later ships; in other words, the third, fourth, and fifth of the kind. Again, the performance of the shipyard, in adherence to its budget, has been quite excellent.

Senator Nunn. Of course there is always the possibility that the cost estimate was higher than it should have been in the beginning. I have to admit that is usually not done. It is usually the other way around.

Mr. Sawyer. A couple of months ago we were talking about more realistic cost estimating in some of these areas. There is no question that is a possibility, but that is what we call a high quality problem. Generally, when we err, we tend to overrun the budgets, not underrun them.

Senator Nunn. I agree with that.

Mr. Sawyer. Proceeding on in the area of contract administration, I think it is important to recognize that we have made some major strides in the area, essentially increasing the size and capabilities of our supervisors of shipbuilding. In the last 2 years, the staff of the supervisors of shipbuilding at Ingalls has been increased by almost 21 percent. In addition, the audits which have been conducted at Ingalls by D.C.A.A., mostly at the request of the supervisor of shipbuilding, were performed at a frequency which, in fact, is greater than the normal frequency of floor check audits or spot checks, precisely because D.C.A.A. and the supervisor recognized the influx of commercial work into the shipyard commencing in the summer of 1980.

[At this point, Senator Nunn withdrew from the hearing room.]

Mr. Sawyer. The result of those audits are significant. To date, based on both the floor check audits and the internal audits which Ingalls has performed, a total of about 15,000 hours, based on the Ingalls' audits, plus 2,000 hours more raised by the so-called C.D.I. issue, plus another 2,000 hours in the engineering shop.

It is important to note that this is the total number of man hours involved, all of which were not necessarily transferred between commercial and Navy contracts. Most of those hours represent mischarges within Navy contracts. To put it in perspective, over those 2 years Ingalls' total production in the shipyard probably amounted to something like 70 million manhours. The bulk of those were at the waterfront, in production. Most of the problems that were the basis of the audit reports which you have seen, and of subsequent investigations, related to the services or support areas.

Mr. Starrett mentioned the fact that at one point in time there were about 50 contracts, both Navy and commercial, being performed in the shipyard. Spreading time charges over that number of contracts makes it very difficult to manage as direct charges. Most of the major work of the contract support element of the shipyard—engineering and materials support—are charged in indirect. There are pluses and minuses to that approach, as well.

Frankly, I would like to see as much time as possible charged as direct charges, particularly since the Government, in most of our shipyards today, is bearing somewhere over 90 percent of the total volume of work. Nevertheless, in those areas where there is a lot of different time to be charged, it is very difficult to allocate time, so that a lot of errors are made.

One audit report indicated that the Ingalls Shipbuilding Division did shift about 480 people in service support out of the direct category into an indirect category. This is not necessarily indicative of deliberate mischarging between or among Navy contracts. The amount of money we are talking about here, in terms of any significant impact on the award fee pool determinations or——

Chairman ROTH. If I could interrupt.

Let me make it very clear that no one has suggested in this subcommittee that this was directed by top management.

Second, it bothers me, it bothers me when we say it is not very important.

Last year we had hearings on the Department of Labor, and some of the things that were going on. Then in the overall figure, it was not very important. That is true. But the fact is there is no point in having cost accounting figures, as your own auditors say, unless they are accurate. So I cannot agree, I do not agree that it is not very important in the overall picture.

I think the thing we want is precision in our figures and I think we want to see aggressiveness on the part of our auditors to make sure that those figures are accurate. But I think we reached agreement yesterday that there wasn't just that one case.

If you look at the audits by the internal people, if you look at the audits by DCAA, there are other cases. The main thing we are trying to get at, Mr. Secretary, is that the problem of mischarging has been a significant one and if it is one that we ought to be concerned with.

We are not trying to suggest in any way that this was something directed by top management. I want the record to so show.

Mr. SAWYER. I agree very definitely. It is important to have accurate records in this area. There have been some comments or allegations that perhaps there was some sort of gaming with regard to cross charging, to improve the contractors' position with regard to an award fee decision or derive profit.

Chairman ROTH. But as Senator Cohen, I thought very rightfully pointed out, even small amounts can make a difference when you get into a competitive position.

Mr. SAWYER. Yes, sir. That basis will be on the fixed price incentive type contracts, competing at the front end.

Last, with regard to the allegations about furnishings, these involve the destroyers which had originally been under contract for the Shah of Iran, and which the Navy completed.

In this case, it is clear that improper furnishings were provided to the ships. Based on our reviews, we do not condone either the judgment or lack of controls that were applied in this case. At the direction of the Chief of Naval Operations, the Inspector General of the Navy is now conducting an investigation of the entire matter in order to fix responsibility. When this matter was first brought to the attention of senior management in the Department of the Navy, procedures were changed immediately by the Naval Sea Systems Command. In addition, the Deputy Chief of Naval Operations—Surface Warfare—sent out a message immediately to remind commanding officers about the need for austerity.

Our audits and review of the case do indicate, however, that we got what we paid for.

Mr. **Sawyer.** And that neither the contractor nor any individuals in the Navy profited unduly from these procurements.

I wish to assure you that upon the completion of this investigation by the Inspector General of the Navy, further action will be taken.

That concludes my oral remarks, Senator.

If there are any questions, I would be most happy to answer them.

Chairman **Roth.** I will be quite brief, Mr. Secretary.

Let me go back to the question of fixed fee.

As you stated in your testimony and that of the previous witness, under our cost reimbursement type contracts, the only incentive you really have to try to keep costs down that is built into the contract is the fee itself.

It is my understanding that in the initial contract, you mentioned the four factors that were involved, cost being one, 15 percent, but that there was not written into the contract the criteria, the standards, the factors that would be considered in determining whether or not the incentive fee would be; is that correct?

Mr. **Sawyer.** I will defer on that to Admiral Fowler.

Admiral **Fowler.** Admiral Meyer, since he administered that fee pool, let's let him explain it.

Chairman **Roth.** It is a very simple question.

Admiral **Meyer.** Yes, it isn't correct.

Chairman **Roth.** It isn't correct?

Admiral **Meyer.** No, sir, it is not.

Chairman **Roth.** Would you, please, describe what it contains?

Admiral **Meyer.** We have in the four categories written into the contract very specifically items as to how they are to be evaluated: under technical, detailed design, budget construction, reliability, test and trials, maintainability, ship characteristics, greater logistics support, management performance, management systems and information, liaison with project manager in RCA, contract management, procurement manager, material management, configuration control, QA program, so forth.

Under schedule, DOD instructs 7000.2, schedule performance, overall contract schedule performance, technical milestone performance, early schedule problem identification, material purchase delivery, waterfront services.

Under cost, is DOD's instruction 7000.2 as related to cost performance, early cost problem identification correction, budget cost performance and cost reduction efforts.

Those are all explicitly called out in the contract.

Chairman **Roth.** What weight do you give each of those factors?

Admiral **Meyer.** In the case of *Ticonderoga* herself, CG 47, the weighting distribution was 45 percent for technical.

Chairman **Roth.** I am not being clear. I understand the breakdown. You are talking about the four factors now?

Admiral **Meyer.** Yes.

Chairman **Roth**. Is there any breakdown of the factors within each of those?

Admiral **Meyer**. No. That is not broken out.

Chairman **Roth**. I would ask the Secretary again.

I am not so concerned about the specific contract as I am the general. Again, it is the fee that provides the incentive to maintain low cost.

Do you think it is adequate to just list those factors or do you think it would be a better negotiating or contracting practice to spell out in some detail how these factors would be weighted?

Mr. **Sawyer**. Admiral Meyer is using verbal shorthand—using DOD Instruction No. 7000.2, with regard to both the cost and technical factors. DOD Instruction No. 7000.2 is a very basic, precise instruction with regard to how major programs are estimated and administered.

It is the basis of a work breakdown structure of the contract deliverables. Its purpose is to break them down into the lowest common denominator, and it makes possible the breaking down of large, complex programs. So when we say in cost control that we are checking how the contractor is administerng the 7000.2, we are evaluating how well he is administering his actual costs as compared to his planned or budgeted costs.

That is what we are saying in verbal shorthand, down to exquisite detail section by section and department by department. This, incidentally, is where much of the complexity in time charging exists, and is why we talk about so many different types of subelements and tasks on the timecards.

It is an extremely rigorous procedure. In some cases it took shipyards many years to be able to qualify their systems in accordance with that DOD instruction.

Ingalls was one of the first shipyards that had a qualified system. So, basically, during those quarterly review meetings, he is reviewing how the contractor is performing to his budget.

Chairman **Roth**. Let me, if I may, I will get to you, Admiral Fowler.

It is my understanding that in other contracts, it has been the practice to include more specific weighting; is that correct?

Mr. **Sawyer**. Yes. It can be under certain type of incentive contracts.

Chairman **Roth**. Was this an incentive type contract?

Mr. **Sawyer**. In certain types of incentive fee contracts, you will have a direct proportion which will be stipulated in advance.

One of the reasons——

Chairman **Roth**. The reason I raise this—I don't want to get into a long harangue, but we were told that it was an oversight in this particular case. But that is water over the dam. But I am concerned that the fixed fee, the incentive fixed fee, is the one incentive we have to try to keep costs down.

Would you agree with me that the more you are specific, the more you treat it with particularity, the greater incentive that you have?

Mr. **Sawyer**. No question about that, Senator. Also, we introduced competition into the equation.

Chairman **Roth**. I strongly agree with what Senator Nunn said earlier and what I said yesterday, that I think the real protection for the Government is to build competition into the picture at an early stage and then to have a fixed price contract.

I think that is absolutely right.

Senator Cochran?

Senator COCHRAN. Thank you very much, Mr. Chairman.

You mentioned in response to the chairman's question about Ingalls being one of the first yards to establish a system of cost identification, data collection, schedule, and performance in fulfilling its obligations under a major weapons system construction. Tell us about that. I think you have that in your statement on page 8 which is a part of the record but we didn't get to hear about that. Could you elaborate on that, tell us the significance of that?

Mr. SAWYER. This relates to the heart of the matter of time charging, and the complexity of the administration of major contracts. This instruction was initially issued in 1972. It is the basic bible for work definition and cost estimating, for the budget of major projects within the DOD, and includes not only ships but also aircraft. It is a very detailed instruction which sets up a work breakdown structure from the highest level of the organization down to, for example, a pipe shop or some subelement of a pipe shop.

Many programs are estimated and budgeted in accordance with that instruction by building up the manhours and material costs, and then are administered on the basis of that structure.

It took many of our shipyards a number of years to qualify under the instruction; in fact, there are some shipyards that still have not totally qualified their systems to 7000.2. I believe Ingalls Shipbuilding was one of the first shipyards in the United States to do so.

Senator COCHRAN. That was in 1977, I believe?

Mr. SAWYER. Yes, sir.

Senator COCHRAN. They did complete that and put that procedure together. It was certified by the Navy, was it not, in October 1977?

Admiral FOWLER. That is correct.

Senator COCHRAN. There have been suggestions by some members of the subcommittee and others that Ingalls Shipbuilding, by charging time devoted to commercial contracts to the Navy, fattened their profits and in effect ripped off the American taxpayer. Is that your opinion?

Mr. SAWYER. No, sir; not at all.

In all of the allegations to date, a relatively limited number of time charges have been involved between commercial and Navy work. One item is this original estimate that Ingalls put forth of $20,000 of mischarging which some have erroneously cited at $137,000. I think it is important to recognize that the original estimate of $20,000 really amounted to not $137,000, but $47,000 in terms of actual time. There was a $90,000 penalty assessed, and that is how we got from $20,000 to $137,000. Any hour mischarged is improper. However, the amount of time here is very small in comparison with the magnitude of work performed under the contract—the Aegis cruiser involved 7 million man-hours of work. While I am not trying to indicate that it is not a matter of importance and significance, the 2,000 hours must be considered in its proper context before drawing any conclusion that this mischarging was an attempt to defraud the U.S. Government.

Senator COCHRAN. There has also been a suggestion made by some that by juggling time between Navy contracts, the company could put itself in a better competitive position with respect to other shipyards.

Is it your opinion based upon your review of the facts relating to Ingalls and the alleged mischarging that the company did succeed in putting itself in a better competitive position?

Mr. **Sawyer.** There is nothing that I can see at this time, on the basis of all of the evidence that is available, to indicate that this would be the case.

We are contemplating a major award to Ingalls this year for three 1983 cruisers. This will be on a fixed-price-incentive-type contract, so the shipyard will have gone from cost-plus-award-fee to fixed-price-incentive.

In view of that major pending award and in view of these allegations, we have assembled a small review team to settle in our minds that all of these issues are in the perspective that we now think they are and believe they are going to be, before we make the award of the contract.

Senator **Cochran.** The Navy has paid particularly close attention, has it not, to the construction of the Aegis cruiser, because it does constitute a major weapons system for the Navy, a platform for missiles, that is new to the Navy.

What is your opinion at this point having had a chance to take a look at the *Ticonderoga* that has been built by Ingalls as to its workmanship and the compliance by the company with the specifications with the Navy and the end product?

Mr. **Sawyer.** The end product is outstanding. I think I will let Admiral Meyer discuss this as one of the "proud parents" of that ship.

Admiral **Meyer.** Thank you, Mr. Secretary.

In a perspective of having been some 13 years now in this post and of course I start periodically from some of the assertions that perhaps were not cost incentive in this program, we achieved what we set out to do.

We priced this ship program actually back in the year 1976. That was a long time ago. I want to assure this committee that from my position, you fight for every bloody nickel you get programmatically in getting a ship costs put together by our own estimators.

We awarded that contract competitively in September 1978. The other day, I checked the log to see where we had publicly announced the day we would commission that ship. It turned out that subsequently, in February before Mr. Ichord's committee, we publicly announced the day we planned to the commission her.

We did it on that day. We did it in the budget, both in dollars and time that we set out to do it in.

I think that is pretty good. When I go back through these award fees, some 18 quarters worth, 4½ years worth, I find that the times where Ingalls was dinged by the award fee board had to do with costs.

You will recall that through those years we suffered some significant inflation. As a matter of fact, I had the figures drug out here this morning that in the programmatic pricing of these ships, I was permitted some 37 percent over all of that 5 years.

The actuals have turned out to be 48 percent. Since this ship was programmatically priced at something like $930 million, it turned out there is $100 million difference, just in inflation.

We didn't get that. We got $28 million for inflation, which was some 3 percent. We are on the down side, almost done with this ship and she has converged in her costs.

When I look back at 1980, we are starting to have problems in that yard, both from overhead rates, work load down, plus the runaway inflation. That is where we and the Ingalls management went at it and brought it back into budget.

When I look at the facts is where they lost the most award fee is their ability to control those costs.

Senator Cochran. Mr. Secretary, in your response to the chairman's inquiry on these items that were purchases by some ships for outfitting the wardroom, the captain's quarters and the like, there is suggestion that maybe the Navy got kind of carried away in allocating some big dollars to outfit these quarters.

I presume that that practice is going to change. It does appear that you have gone overboard.

I want to ask you what your policy has been if that was indicative of the way ward rooms and captains' cabins were being outfitted on all of those destroyers, or was there some policy that fell through the cracks somehow on a few ships.

Mr. Sawyer. Let me say that I think it was something that fell through the cracks. We reviewed the DD 963-class destroyers, for example, and the average improvement cost figures for the last group of 10 ships of that class. It averaged about $20,000. Looking at the FFG–7 class figures, specifically the last group of 10, we are talking about an average of about $20,000.

In the case of the DDG–993 class, the average improvement costs amounted to $180,000. So, even though this is still being looked into, I must conclude that our controls were not as tight as they ought to have been and that the judgment applied was by no means as mature as it should have been.

We don't see this as a general pattern throughout new construction. The investigation is still ongoing, and should be completed in a few weeks. I am sure you will be hearing a lot more about what we have done about it. In the meantime, I assure you it has been stopped.

Chairman Roth. If the Senator would yield?

Senator Cochran. I would be happy to yield, Mr. Chairman.

Chairman Roth. As was indicated yesterday, we did receive a letter through Senator Percy saying that you are investigating.

I would request that on completion of your investigation and whatever action you take that that be reported to this subcommittee.

Mr. Sawyer. Certainly.

Senator Cochran. Let me ask you the connection of the shipyard and its management to the decisions to outfit those ships.

That decision was not made by Ingalls, as I understand it, certainly not in those cases that were described in yesterday's testimony; is that correct?

Mr. Sawyer. That is correct.

Senator Cochran. That is a decision made by somebody in the Navy; is that right?

Mr. Sawyer. That is correct.

Senator Cochran. There has been a suggestion that in response to some of these DCAA audits and even maybe some internal audits performed by Ingalls itself in connection with the erroneous charging of the time to contracts, that some of these findings were ignored and nothing happened

While you didn't include it in your verbal testimony, I think that on page 7 of your statement you indicate that between August 1980 and March of 1983, 13 floor checks by DCAA indicated a need for corrective action and in every case, Ingalls took corrective action to bring procedures into compliance; is that correct?

Mr. SAWYER. That is correct, sir?

Senator COCHRAN. That is all I have, Mr Chairman. Thank you.

Chairman ROTH. Senator Cohen.

Senator COHEN. Thank you, Mr. Chairman.

Let me make something perfectly clear from my perspective. I happen to enjoy the unique position of being chairman of the Subcommittee on Seapower and Force Projection which has jurisdiction over the entire shipbuilding program. And I have no occasion to find any fault with the Ingalls shipyard. I, in fact, intend during the course of our markup to authorize the construction of three Aegis cruisers at Ingalls. In fact, there is opposition within the subcommittee which has nothing to do with Ingalls as far as the construction of the Aegis cruiser. There is now a movement on the part of some of our members to challenge the whole concept of the Aegis cruiser itself, that it is not seaworthy, it is overloaded, it is too heavy, it can't turn, it hasn't performed its sea trials properly.

I discount those. I think based on the evidence that I have seen that the Aegis, indeed, is a fine ship and it has been built to specifications. So from my perspective I have absolutely no complaint to lodge in that regard.

My question should not be interpreted in that way. My questions are more on a broad plained basis, namely, if any contractor, whether it is Rockwell, who is building the B-1, and if they should be charging work to under their NASA program for the space shuttle program and shifting costs to hold one or the other down, that is wrong. I don't think that is the case. But if that were the case that would be wrong, in any particular defense contractor who might be engaged in trying to mischarge funds or realine them so it reflects a lower cost of one facet of the budget as opposed to the other.

That would be improper. I am simply suggesting that if that occurs by any contractor, today, Ingalls, BID, any contractor, it ought to be stopped because in fact it would have an implication if you charge one ship to another, you hold the line on one ship, you meet your cost, it looks good on paper, it looks good in terms of performance, it has an impact for the future years.

Since we are in a highly competitive situation, now thanks to the Secretary of the Navy who has decided to put more competition into the shipbuilding program which is long overdue, we are going to have an even more intensive level of competition by the shipbuilders. So I think it is important that we try to have uniform rules of procurement, oversight, enforcement, audit as we try to hold down the costs and get the best ship we can for the least amount of taxpayer dollar.

So my question should be interpreted solely in that light, that I intend to support the construction of these ships at Ingalls.

I would like to move to another area, that is, on this NAVSEA, apparently allows contractors to have a nonvoting seat on the Government award fee. Is that true? Is that as a general policy of the Navy.

Admiral **Meyer**. I would like to field that. I would like to speak for my unique position in fielding it because probably more than any other person in uniform I have been associated with award fee contracts through the years. And the policy is not an universal one as far as I know but in any contracts in which I have been associated at Ingalls, Bath, General Dynamics, that has been true, that the general manager, RCA general manager has been part of the proceedings.

Interesting enough Mr. Hildago felt so strongly about that that he wanted to institutionalize it in the Lavy and I was opposed to it as a process. It is done on a continuing basis in the contracts that are administered under the Aegis project.

Senator **Cohen**. Just on the Aegis project?

Admiral **Meyer**. That is my field.

Admiral **Fowler**. Those kind of contracts fairly recently have been used in shipbuilding. We have used them in my previous command, Commander of the Naval Electronics System Command, and we used those contracts, this type of contract for a number of years. In all cases that I can think of we had a company representatives on the award fee committee. We find this to be very effective. In fact I usually find the company representative to be as critical of the company's performance as anybody on the fee. I wanted to respond a little bit to Senator Roth a while ago.

He was implying that the only incentive in this type of contract is the fee itself, seemed to me to somewhat understate the case because the award determination process causes the Government and the industry management to take a hard look at what their objectives are on a quarterly basis and to take a hard look at to whether they are determining those objectives. The fee itself is important and certainly it is important to both the Government and to the management but there is a sense of objectivity, a sense of where you are headed and what you need to do to get there that is created in this process, I think that should not be overlooked or minimized. It is a very important part of the process. It is one of the things that makes this technique effective for the type of equipment you are buying on that contract.

Senator **Cohen**. You say you found general managers are even more critical than the Navy personnel? Have you found the situation in which the onsite personnel have made recommendations on the fee awards that have been less than when they finally arrived at because they don't have the big picture?

Admiral **Fowler**. No. I can't really say that.

Senator **Cohen**. I notice this practice, it may be unique to the Navy, but it is not followed by the Department of Energy nor NASA, some of the major agencies that have large contracts. I am wondering about the wisdom of doing that.

Admiral **Meyer**. I think the operative word, Mr. Sawyer said earlier, it does take mature leadership. It varies in the witnesses that come before my panels, some are by nature very tough and some are not as tough. Some view the elephant in a different manner. It becomes the job of the award fee panel to integrate up to the various views of the elephant and the general manager has one, I operate on the premise that you can't expect the general manager to correct something if he doesn't know about it.

The best way for him to know about it is put it right in front of him.

Senator COHEN. What I am saying is you can't expect the general manager to be arguing against his own company's interest either, whether that is Bath, having the president of the company make a recommendation that is higher, saying you really haven't taken into account what we have accomplished here and we deserve more than that and you haven't been fair. I would assume that would be the case of the general manager. He can't go back to BIW or Todd and say: "Well, we really didn't measure up under this one. WI only got 80 percent instead of 90 percent fee award on this because we got to do better next time." I won't expect a manager to do that.

Admiral FOWLER. I think that is too narrow a view. I think in fact he would be willing to fess up to something on a quarterly basis to achieve a longer term objective which is to get a better project. In the long haul he is going to stay in business and be more effective in doing business with the Government if he delivers a better product on schedule.

Senator COHEN. Have you found a case where any general manager has recommended a lower award?

Admiral MEYER. First of all, we should make it clear that the general manager doesn't vote on his own award. He is a participator.

Senator COHEN. He is an advocate.

Admiral MEYER. He doesn't vote on a contractual or legalistic basis.

Senator COHEN. He doesn't vote but he certainly has a voice.

Admiral MEYER. Sure. In 13 years, and I would say by this time, 14 or 15 general managers, I have never once had a rhubarb or a violent exception on the part of the general manager to what the award fee panels determine, that is to say, the integrity of the process was accepted and understood, and as Admiral Fowler said, we have to operate on the premise that general managers are mature people most of the time.

Admiral FOWLER. The other thing is I operate on the principle if I don't like what the contractor is doing the most important person I have to tell is the contractor. We have got all of these people running around finding things they think are wrong but the last person they ever want to tell is the guy who has the authority to correct it. It is an amazing mentality that goes on.

I just can't conceive of what the motivation is for people who think like that.

Senator COHEN. Stranger things have happened, Admiral.

Admiral FOWLER. Undoubtedly, particularly here.

Senator COHEN. Let me say that Senator Cochran raised an issue about items. We had hearings on the concept of hurry-up spending and the chief focus happened to be on the fact of how agencies rush toward the end of their fiscal year to unload their budgets, for fear if they come in under budget during the course of any given year, Congress looking at that will say they had a good year last year, they saved 10 percent of their budget, therefore we will reduce that budget by 10 percent.

They were rushing toward the end of the fiscal year to buy whatever they could. We found some rather horrendous examples of buying color television sets, oriental rugs, 200 pair of chaps for 100 students enrolled in some camp, it went on and on. Of course that is what the public attention focused upon, were those items egregious as they were, outrageous as they were, they didn't total up to very much in terms of the real dollars being lost through having that kind of practice and the lack of competition during the course of the year where we were losing millions and we estimated about $2 billion during the course of the year.

While we tend to focus on the most outrageous parts, nonetheless the big dollars are involved in these other sums whether we are getting good contracts, whether we are really getting the most competition we can, whether we are enforcing procedures. It is within that light that I think we have to look at the comparability as well, because when we have the BGA, Better Government Association, they testified they can buy 11 switches for $12 each, the Navy is buying the same thing for $256. It is difficult for us to explain that.

This may not be a lot of money. Yet it is a very visible symbol of the fact we aren't too cost conscious. How do you respond to that?

Mr. **Sawyer**. With regard to the issue of the furnishings for the DDG-933 class destroyers, an interesting point is that this is a contract where the Navy saved a great deal of money. In fact, $30 million has been deobligated to date, and the total savings on that contract may run to $50 or $60 million. This might be an example of a situation where there was too much money. So the best way to respond to your question is to say that in certain areas I think the people at BGA are on the right track. We have got to keep watching for it, stamping it out. It is not all that easy.

Frankly, my own personal feeling is I want to thank the BGA for coming forward and finding that out for us, and letting those of us sitting in the Pentagon know about the furnishings on the 993 class destroyer.

Senator **Cohen**. It is not only the shipbuilding. We have had hearings again recently—my figures are probably wrong—but we had testimony dealing with one of our aircraft in which we paid something like $1,400 for a ladder for the pilot to get into the cockpit, when in fact you could probably buy something comparable for about $120 at a local store. This is something that is important to people, why are we spending $1,400 for such a ladder? That is part of that waste that people see, it is one of the reasons why we are having such a difficult time with our defense budget because everybody is under the impression that we could cut a lot of our defense budget and not impair our defense.

I don't think it is true. But certainly there ought to be savings that we can achieve on closer watch through some of these items.

That is all I have, Mr. Chairman.

Chairman **Roth**. Senator Stennis.

Senator **Stennis**. Mr. Chairman, I thank you.

I just want to make this observation relating to the rebuilding of the Navy. I hope you put something in the record that better describes just what the *Ticonderoga* is, what it will do, what it will achieve. That is apart from Ingalls or whoever built it. It is a great step forward, I think, in rebuilding the Navy.

[Information referred to above subsequently received by the subcommittee follows:]

Department of the Navy,
Office of Legislative Affairs,
Washington, D.C., June 14, 1983.

Mr. David Glendinning,
Counsel, Permanent Subcommittee on Investigations, U.S. Senate, Washington, D.C.

Dear Mr. Glendinning: In response to your request for information on AEGIS Class cruiser, the attached material is forwarded.

Sincerely,

D. A. Ritchhart,
Captain, U.S. Navy, Director, Navy Program.

Enclosure.

U.S.S. *Ticonderoga* (CG–47) has joined the Fleet. She is the most capable and survivable guided missile cruiser ever built and is the first ship designed and built to kill anti-ship missiles as well as manned aircraft. The advanced technology of her Aegis Weapon System is ideally suited to her primary mission: protecting Aircraft Carrier Battle Groups from "saturation" attacks by subsurface, surface and air launched cruise missiles.

Early on, an assessment of the threat led to the identification of five key variables which drove the Navy to develop a system with greater capabilities then currently existing. They are:

Reaction time.—The most demanding variable: approximately ten times faster reaction is needed to defend against the expected attacks.

Firepower.—More ammunition must be fired and controlled in the air at one time than ever before to defend against saturation raids.

Environmental immunity.—The system must perform in the presence of electronic jamming and chaff created clutter.

Area coverage.—An accurate, coherent air picture from long range to the zenith must be available.

Availability.—The system must be on-line and ready for action over 95 percent of the time.

These are the cornerstones for development of the Aegis Weapon System. Aegis, with its AN/SPY–1A Radar, MK–26 Launchers, Standard Missiles and various control systems, can detect and track hundreds of potential targets, evaluate their threat and fire when necessary.

This is just part of the U.S.S. *Ticonderoga* story. The Aegis Weapon System is the core to the larger Aegis Combat System, which includes surface-to-air Standard Missiles, two 5"/54 Caliber Guns, two Phalanx 20mm Gatling Guns, Harpoon Surface-to-Surface Missiles, deck and air launched torpedoes, anti-submarine rockets, Seasprite or Seahawk helicopters, and electronic jammers and decoys. No other ship packs so much firepower and mission versatility into so little tonnage. She will sustain herself and defend the Fleet under the most demanding conditions.

All this "new" capability is in U.S.S. *Ticonderoga,* commissioned January 22, 1983. But is it new? No, it has been tested and proven over the last ten years, both ashore and at sea. Since 1975, The Aegis Combat System has undergone some 33,000 hours of tests at Moorestown, N.J., and 59,000 hours of test in the Aegis test ship, U.S.S. *Norton Sound* (AVM 1), offer the California coast. Prior to commissioning U.S.S. *Ticonderoga,* there were 139 at-sea firings, at missiles, airplanes and other targets representing an extensive variety of scenarios, including multiple engagements. Manned aircraft, carrying powerful, specially-built electronic jammers have registered 800 hours attempting to defeat Aegis. The Weapon System at Moorestown tracks some 500-1000 targets each day. In all, over 2,000 tactical scenarios have been engaged since 1975.

And testing continues today. During builder's trials, U.S.S. *Ticonderoga* became the first major warship to fire all her weapons prior to commissioning. This included two kills with Standard Missile. Recently, U.S.S. *Ticonderoga* completed an impressive series of qualification trials. She took on thirteen targets representative of Soviet anti-ship missiles and defeated all thirteen with her Standard Missiles without resorting to her other defense-in-depth weapons. By all accounts, she was devastating. As one Navy official put it, "She left behind her a wake of destruction".

Aegis shipbuilding is one of the most ambitious enterprises ever undertaken by the Navy. Technologically, managerially, financially, economically and logistically it is an enterprise of great magnitude and complexity. For example:

The AN/SPY-1A Phased Array Radar is a step increase in fleet radar sophistication.

The eighteen Aegis tactical computer programs number over 1,200,000 words, and additional support programs number over 1,500,000 words. Together, they are perhaps the largest in the Department of Defense.

Four prime contractors on three coasts separated by over 4,500 miles, as well as thousands of suppliers are involved. About $2.2 billion in jobs in over forty States and Canada are created yearly through this program. That figure will increase by a factor of almost two by 1986.

Over 7 million man hours of work at Ingalls alone were spent in constructing U.S.S. *Ticonderoga*. This does not count similar amounts of time at RCA producing the Aegis Weapon System and countless other hours at the many weapons and equipment contractors throughout the Nation.

U.S.S. *Ticonderoga* took five years to build. Throughout that time, unanticipated double-digit inflation occurred. The original estimate understandably mis-gauged that inflation by at least 10 percent, or nearly $100 million. Two-thirds of that inflation was absorbed using good, sound, belt-tightening leadership both within the Navy and industry.

Perhaps the words of Seapower Magazine in its January 1983 edition best sum up Aegis' management responsibility.

"The Aegis program is, in fact, more complex in several respects than the Polaris program, the successful completion of which has been hailed as a classic in modern management. The Polaris submarines, and their Poseidon and Trident successors, had and have but one all-important mission: deterrence of nuclear war. To carry out that mission, the SSBN's are obliged to avoid contact with the enemy; their job is done only if they never have to fire a shot in anger.

"*Ticonderoga*'s are designed, on the other hand, to go in Harm's Way. They must be able with absolute certitude to meet and defeat the enemy—on and under the water, in the air, and, if need be, on land. To sequentially or simultaneously carry out those several missions requires a mind-boggling variety of ordnance, sensors and detection devices, and sophisticated electronics systems of all types ranging from air surveillance and fire control radars to sonars to terminal guidance systems for anti-air missiles.

"Identification and procurement of the many items of ordnance required by the Aegis ships were, in a sense, the easy parts. Integration of those systems into a smoothly functioning whole was much more difficult and required the utmost in both industrial ingenuity and management expertise."

To assure authority, responsibility and accountability, the Aegis Shipbuilding Project was chartered in 1977. For the first time in Navy history, one Project Manager was delegated this authority, responsibility and accountability for both the Combat System and the ship—not only their initial production and construction, but also for their continued life-time support, maintenance and crew training. The success of that endeavor is found in U.S.S. *Ticonderoga* herself.

The ship has been called "expensive." Expense, however, is often both a relative and an accounting term. For example, while the "up-front" construction costs were significant, the number of sailors required to man these ships are much less than those cruisers U.S.S. *Ticonderoga* replaces. This translates into significant operational savings over the next 30 plus years. Ultimately, expense must be measured by "what we wanted" and "what we got," recognizing that neither preparation for nor war itself is cheap.

Today the ship is at sea. All initial fleet reports have been enthusiastically upbeat. In terms of the Latin expression. "res ipsa loquitur," U.S.S. *Ticonderoga* "speaks for herself." While the job of fielding this guided missile fleet is far from done, there has been a momentous start. The country got what it needed and all those involved and responsible should be justifiably proud of their accomplishments.

Chairman ROTH. Senator Stennis, could I ask you, if your staff has any material, we would be happy to keep the record open for that purpose?

Senator **Stennis**. That is very nice. You mean pull together something and give it to your staff? All right.

Chairman **Roth**. Yes, sir, if that is satisfactory.

Senator **Cohen**. Mr. Chairman, I will be happy to furnish whatever we are going to mark up next week.

Senator **Stennis**. I would say, Senator Cohen, that you have this matter, probably somewhere else, and you are handling it in your subcommittee. Your information will certainly be fine.

I commend these gentlemen highly, based on what I know about what they have done in rebuilding this Navy, with this particular ship. I understand probably it is the most effective warship in the world today. That is the way I hear it described in all of the reports. I thank you very much. It is not a matter of questioning, but commending these gentlemen for what they have done.

Chairman **Roth**. The only final matter, I would like to go back to the point Senator Cohen raised, and that is the question of the general manager. I am not certain what the right answer is. But it does seem to me that it may be something that the management of the Navy ought to consider. It is not only what the facts are, it is what the perception is. The fact is, however, that the fee and the amount of the fee is the principal incentive beyond the general reputation of the yard and desire to continue receiving contracts. It is important.

The fact is the fixed fee is the basis on which you award those that are efficient and provide lesser award for those that are less efficient. So that it seems to me that this is something that perhaps ought to be determined at a higher level—just what the policy is. And I would urge you, Secretary Sawyer, to take a look at that.

Mr. **Sawyer**. We definitely shall review that matter.

Chairman **Roth**. That is all the questions at this time.

Thank you, gentlemen.

[Correspondence containing questions from Senator Roth to Hon. John Lehman, Secretary of the Navy, and his response thereto, subsequent to the hearings follow:]

U.S. Senate,
Committee on Governmental Affairs,
Senate Permanent Subcommittee on Investigations,
Washington, D.C., May 6, 1983.

Hon. John Lehman,
Secretary of the Navy,
The Pentagon, Washington, D.C.

Dear Secretary Lehman: I want to extend my thanks for the testimony of Assistant Secretary Sawyer, Vice Admiral Fowler, and Rear Admiral Meyer before the Subcommittee on May 4, 1983.

Due to unforeseen time pressures, we were unable to fully question the witnesses at the open hearing. I have ordered that the record be left open to include the following questions and your response thereto:

1. Over the period of our study of the Ingalls Shipyard, I requested numerous Naval Investigative Service closed reports that dealt with serious matters at that Shipyard. In discussions with the Navy it was made clear that we wanted the reports rapidly and unedited so that this Subcommittee could complete its mandated work with full information.

Nevertheless, it took over four months for the Navy to respond with the reports. Further, important identifying information had been deleted from the reports.

Please explain the delay this Subcommittee experienced in receiving the reports and further explain why the full information we requested was not forthcoming.

2. Report after report by the DCAA cites mischarging and time keeping problems at Ingalls Shipyard. To which Navy representative, if any, were these reports directed? What did the Navy do with the information contained in the DCAA reports? Did NIS ever undertake an investigation at Ingalls based on information provided by DCAA during the period 1975–1982?

3. The Navy routinely received DCAA reports on mischarging government contracts at Ingalls Shipyard. Why didn't the Navy, as a prerequisite to paying contractual progress payments, require Ingalls to correct its labor accounting procedures and practices?

4. Isn't it true that, if the actual direct labor charges for the CG–47 are unknown, the Navy cannot negotiate realistic target costs and ceiling prices on new contracts?

5. In the last ten years, has any Navy representative formally recommended that a Navy shipbuilding prime contractor be suspended or debarred for fraud or misconduct?

6. Regarding award fee panel meetings on the CG–47, was information solicited from your local Navy personnel at Pascagoula who were dealing with the contractor on a daily basis? How important were their views?

7. The Subcommittee staff was told by NAVSEA personnel that the award fee recommendation of on-site Pascagoula Navy personnel was often increased by the panel because the on-site personnel don't see "the big picture". On how many occasions was the panel's award greater than that recommended by subordinate Navy personnel?

8. In Pascagoula, the NIS agent seems to take his orders regarding what to investigate from SUPSHIPS and does not investigate unless SUPSHIPS and does not investigate unless SUPSHIPS so requests. Is that NIS policy? If so, what is to prevent SUPSHIPS from halting an investigation it believes will be embarrassing?

9. What is NIS policy regarding working with DCAA and what formal or informal agreements exist regarding sharing information relating to potential fraud?

10. The Navy received information from a former Ingalls employee that contained serious allegations of falsified time reports and diversion of funds by Ingalls Shipbuilding. That information, contained in a mailgram dated 19 December 1980, had also been received by Ingalls. The Navy, by the Supervisor of Shipbuilding, turned the matter over to Ingalls to investigate. Ingalls gave itself a clean bill of health. The only subsequent Navy action was to request the NIS to reinterview the informant to determine if he had any further information. He did not and so the Navy did no further investigative action but, based on Ingalls' investigation, closed the case.

Is it Navy policy to turn over serious allegations to the suspect for investigation?

11. What is the Navy's policy regarding protection of "whistleblowers" identities? Why was Mr. Ed Fite's identity revealed to Ingalls almost immediately, even though his first fear was that he would lose his job if discovered? Navy correspondence indicates Fite may have saved the Navy approximately $5 million. Did the Navy ever protest his subsequent treatment by Ingalls?

Please submit your answers to these questions by May 20, 1983.

Sincerely,

WILLIAM V. ROTH, Jr.,
Chairman.

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., June 3, 1983.

Hon. WILLIAM V. ROTH, Jr.,
Chairman, Senate Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your letter of May 6, 1983, in which you requested answers to eleven questions concerning the Navy's shipbuilding program at Ingalls Shipyard.

In reply to question one, the delay in providing the Naval Investigative Service (NIS) reports requested by the Subcommittee resulted from a current review of internal Department of the Navy procedures to ensure our information release policy adequately safeguarded the personal privacy of the individuals named

in the report. As a result of this review, which included canvassing the policies of other Federal agencies and military departments, I directed that, in this instance, we respond to the Subcommittee's request by providing copies of reports with personal information deleted, thus providing the Congress with facts while safeguarding personal information.

In reply to question two, most Defense Contract Audit Agency (DCAA) reports have not cited mischarging and timekeeping problems at Ingalls Shipyard. Most of these reports found no examples of contract mischarging and only one report uncovered any mischarges between Navy and commercial work. The level of timekeeping problems reported was not unusual for a company with the business base of Ingalls. DCAA reports are discussed in more detail in response to question three.

DCAA reports were provided to the Supervisor of Shipbuilding, Conversion, Repair, USN, Pascagoula, Mississippi (SUPSHIP), addressed in most cases to the Administrative Contracting Officer. Reports recommending action were discussed as warranted with Ingalls. Ingalls has been generally responsive to the Navy's position and changed its procedures where necessary. For example, Ingalls converted approximately 480 direct charge employees to indirect charging as a result of DCAA audit conclusions that such employees could not consistently and economically maintain direct charging. There were no NIS investigations initiated based on DCAA reports between 1975 and 1982.

In reply to question three, of the 335 DCAA audit reports issued from August 1980 to March 1983, only fifty-six reports were devoted to Ingalls' timekeeping procedures and included results of floorchecks. In these fifty-six reports, twenty-one contract level errors were reported. Contract level errors are significant because they directly affect costs charged to the government. Of these twenty-one contract level errors, eighteen were between different Navy contracts and only three were between Navy and commercial contracts. In two of these latter three cases, work on Navy contracts was charged to the commercial contracts. These three mischarges were found during one floorcheck and were reported on a single DCAA audit report on November 11, 1982.

The errors reported by DCAA represent results of checks over a three year period into a total Ingalls population of approximately 15,000 workers. The error rates led to no conclusions that significant contract mischarging was occurring. Administrative action to correct the problems was taken without the need to withhold progress payments, an action which could have exposed the Navy to considerable claims liability.

In reply to question four, direct labor charges for CG–47 are known to a high degree of accuracy. In addition, we have accumulated sufficient CG–48 costs in the validation process to have sufficient data for establishing realistic pricing for the FY 83 and out-year cruiser contracts.

In reply to question five, the Navy has not formally recommended a shipbuilding prime contractor be suspended or debarred for fraud or misconduct in the last ten years.

In reply to question six, many people from SUPSHIP as well as several other Navy activities are required to provide information for consideration by the award fee panel. This procedure has been followed during every quarterly award fee panel meeting for the last five years, and the information presented was appropriately considered by the panel members in their award fee recommendations.

In reply to question seven, the Board considers the testimony of several Navy representatives, who report in their specific area of expertise (technical, schedule, management or cost). Although not required by the contract or DAR, these Navy representatives provide recommendations within the specific category at the request of the Board. These assessments and reports are considered by the board members in their deliberations within the context of the total contract. Since no Navy representative recommends an overall grade, it is not uncommon for the final overall award to vary from that recommended by "subordinate Navy Personnel" for specific areas.

In reply to question eight, NIS policy is to conduct investigations upon request by competent naval authority. An investigation that is terminated prematurely at the request of the initiating command would be reported to the Navy Inspector General and to the cognizant Systems Command, NIS special agents are not subject to orders from anyone outside NIS in the conduct of their investigations.

In reply to question nine, NIS and DCAA signed a memorandum of understanding on May 4, 1983, concerning working relationships and jurisdictional matters to improve the sharing of information relating to potential fraud in Navy contracts.

In reply to question ten, it is not Navy policy to turn over serious allegations to the suspect for investigation. The mailgram dated December 19, 1980, was sent to Ingalls Shipbuilding with copies to SUPSHIP, the Chief of Naval Operations, and the Chairman of the Senate Armed Services Committee. SUPSHIP initiated a review of the allegations and, inasmuch as the mailgram was addressed to Ingalls, requested Ingalls divulge the results of their investigation of the matter. SUPSHIP's internal investigation, which included discussions with DCAA, concluded no evidence existed to support the allegations contained in the mailgram. Ingalls' investigation reached the same conclusion.

NIS was requested to locate the author of the mailgram and determine whether he had additional information to support his allegations. The author was located in Houston, Texas, and was interviewed by an NIS agent. No additional information was developed and the case was closed.

In reply to question eleven, it is Navy policy to protect "whistleblower's" identities. In the case of Mr. Fite, the Navy intended to protect his identity and arranged a "routine inspection dive" to give the appearance the Navy had discovered the problem. Unfortunately, the Navy diver asked bystanders who the Ingalls diver was who had discovered the problem. According to his own sworn statement of August 13, 1979, to NIS, Mr. Fite stated "my role in the matter was inadvertently disclosed by a Navy diver at a later date." (Underlining added.) In that 13 August statement, Mr. Fite also stated that Ingalls had not threatened him with the loss of his job. He believes that he was laid off according to union seniority rules. The Navy is now working to find training and employment for Mr. Fite with the Navy as a diver.

I trust the above information will be helpful in completing the subcommittee's record.

Sincerely,

JOHN LEHMAN.

Chairman ROTH. At this time we would like to call forward Roger Olsen, Deputy Assistant Attorney General, Department of Justice, accompanied by Richard Sauber.

Gentlemen, if you will please raise your right hand, do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth?

Mr. SAUBER. I do.

Mr. OLSEN. I do.

Chairman ROTH. Please be seated.

If possible, in the interest of time, I think we have a vote in the very near future, I would ask that you summarize your statement and we will include the full statement as if read.[1]

TESTIMONY OF ROGER OLSEN, DEPUTY ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF JUSTICE; ACCOMPANIED BY RICHARD SAUBER

Mr. OLSEN. Thank you, Mr. Chairman.

The work that this subcommittee, and particularly the staff, has been doing in the area of, and the extent that there is fraud, waste, and abuse in Government spending, particularly defense related procurement and more specifically related to the Navy shipbuilding matters, is an extremely important area that we in the Department of Justice have increasingly been devoting more and more attention and resources.

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[1] See p. 245 for the prepared statement of Roger Olsen.

There is a perception and we believe reality to the fact that we have become more aggressive and have had a more pronounced presence in this area.

There are a couple of reasons for that.

I will just summarize them.

One is that it is becoming increasingly clear that more and more money is being spent in this area from the standpoint of good Government management and looking to preserving the integrity of our procurement programs, that there is certainly a need to better enhance our enforcement efforts.

Second, we have found that in looking back historically over the way we in the Department of Justice have handled procurement cases, and procurement related cases, there is a mixed pattern of results.

We found, for example, in the cases that are large in nature, Lockheed, Electric Boat, Bath Iron Works, and other cases, that the investigations took years to be conducted; thousands of manhours were expended, and in all of those cases, I think we have concluded that we could improve the way we were conducting business.

Many of the cases we found were not initially spent conducting an investigation. Rather, once they were referred to the Department of Justice, our resources were spent trying to learn about the procurement process itself, and understanding the nomenclature, and what was involved in it and what was at stake.

The effect of transferring cases between lawyers also had a dramatic effect on increasing the length of the investigations.

During this period of time, we found that there was a change in the public perception, that either the Department of Justice was unwilling or unable to prosecute. We found that in many of the cases that we could have been better prepared.

In the small cases, however, we found that there was a very different problem and it is a problem that this subcommittee has been asking various witnesses about; that is, in the small cases, we found that because of the declination policies and various U.S. attorneys office's caseloads, some cases were falling between the cracks, for example, they were being declined. Thus, there was no vindication of the Federal interest.

What we have embarked upon is what we think is a reasoned response to solving many of those problems. In the first instance, we set up a fraud procurement unit with Mr. Sauber to my right being the head of that unit. That unit is stationed in Alexandria, Va., in the eastern district of Virginia.

The unit will attempt by its institutional nature, it is not a task force, it is permanent, not transitory, to begin to solve the problems that we have faced before, the problems that the services would conduct investigations, spending years on the cases and, therefore, then refer them to the Department of Justice.

Then we would begin a second series of investigations.

What we are doing now is getting on top of the cases much earlier, addressing the problems, the threshold issues, and deciding whether or not the cases have any criminal prosecutive merit at all.

In some of the cases where we found that there was no criminal merit to the cases, we have referred them back to the audit agencies with an explanation and directives about why they were not criminal, what could be done to improve the way they, the auditors, are doing business as we perceived from the enforcement standpoint, but not attempting to change the way they conduct business. Then, looking at the individual cases that we have, we are beginning to appoint and use lawyers from the Services' General Counsel's Offices, from JAG, et cetera, people who are more expert in procurement law, nomenclature than we are and working with our own Department of Justice lawyers to conduct more thorough and expeditious investigations.

We found that the results are rather dramatic in terms of our ability to evaluate early on the cases and to move them forward.

There are some other things that we have been doing with the Law Enforcement Coordinating Committees that were created by the Attorney General in response to the study that was conducted at his direction by the Attorney General's task force on violent crime, that we are now utilizing all the law enforcement agencies together in regular meetings to discuss how to handle cases of a violent nature as well as procurement nature.

There has been quite a bit of attention focused on the southern district of Mississippi and what the activities are down there.

I can tell this subcommittee that I discussed at length with the U.S. Attorney, George Phillips, the activity and the role and the effectiveness of the Law Enforcement Coordinating Committee down there.

I would like to share some of those thoughts with you.

One is that while declination policies in the Department of Justice have an eroding effect on the willingness of the investigators and auditors in the Federal system to go forward with their cases because they think the Department of Justice is going to decline the cases, what we are doing down there is instead taking the position that all cases that have concurrent jurisdiction with the local and State prosecutors, will be prosecuted locally unless there is some significant Federal interest that demands that the U.S. Department of Justice maintain the case.

Included in the Law Enforcement Coordinating Committee as representatives are various representatives of the Federal law enforcement investigative agencies that would have jurisdiction over Litton Industries down in Pascagoula.

Some other things that we are doing include the establishment of the Fraud and Corruption Tracking System [FACT system].

What is important about that is it is almost in anticipation of some questions I heard earlier, to what extent do we have any statistical evidence about what we in the Department of Justice have done with Government procurement fraud cases.

The answer is this: We historically have not maintained centralized recordkeeping about what has happened to the cases. When cases were declined, we have absolutely no central repository of information.

When cases are prosecuted, the only way we can find out what kind of case it is is to place a phone call or a cable to the various U.S. attorneys offices and ask them to assign paralegals, to begin to try to retrieve the information or ask these questions to various Federal prosecutors.

The FACT system is a reporting system that not only mandates that all Department of Justice lawyers report all cases referred to the Department of a fraud nature, whether they are referred to the FBI, or to the individual U.S. attorneys offices or to the criminal division or civil division, so that we can now begin to look and see what kind of pattern of behavior we at the Department of Justice have in the enforcement area.

What we see also is that we are having more and more interplay with the IG's Office at the Defense Department as well as with the audit agencies, particularly focusing on what seems to be a general concern from the standpoint of the auditors.

How do we identify what is fraud, what is criminal, what is civil, what do we do about it, how should we react to it?

There is a bit of a perception problem from the contractor standpoint, that causes them some concern. The auditors we find are concerned that they will start playing more and more of a role in the fraud area. They believe they will lose their ability to communicate more effectively in open discussion with the contractor, to solve a lot of the audit problems which are not criminal in nature as a result of this change in public perception and in their duties and responsibiiities.

At the same time, it is perfectly clear to us at the Department of Justice that there is nothing magical about what is fraud. The standard really is, from an auditor's standpoint, if he or she conducting the audit, looks at it, what is on paper or what has been represented to them, is so irregular, they are not going to sign off on it, they ought to refer it out and have somebody else look into it more completely.

We think spending time with DCAA auditors and beginning in a lot of the seminars we are having, discussing with them what is fraud, is something that is helpful because it answers a lot of questions.

We don't want them overreacting because not every case is fraud, but we don't want them to overlook a fraud matter due to ignorance.

More importantly, we don't have the resources at the Justice Department to handle all of the cases potentially out there; but more importantly, what we do need to do is identify what are all of the problems in this area.

I would invite any questions that the chairman or other members of the subcommittee have in the short limited timeframe.

Chairman Roth. Thank you.

[At this point, Senator Cohen withdrew from the hearing room.]

Chairman Roth. I feel that it is important that there be better communication and cooperation between you and DCAA. I think the procurement fraud unit is a welcome addition.

Senator Nunn and I am concerned that within the DCAA, there is no one really trained in the area of fraud.

Last year, I introduced a bill, S. 1780, that would streamline the process of recovery of lost Government money.

What it does in effect is permit in certain limited areas administration action to be taken rather than proceed through the more cumbersome legal process of litigation.

Would that be helpful in this area to you?

Mr. Olsen. I had a hand in preparing the testimony of Assistant Attorney General McGrath last year when he testified on the Program Fraud Civil Penalties Act Proposal. We still think, I have checked more recently with our Legislative Affairs Office as well as OMB on what our position is. And the position, I think, is basically the same, that we are very much in favor of it conceptually, we are very much in favor of the proposal that was introduced last year with a few concerns that were, I believe, expressed then.

One is on whether or not the dollar limit would be $100,000 or $50,000. I believe that from what I have now more recently been told is we are still at the $50,000. That is our general thinking. And also, in the area of the Administrative Procedures Act, whether it would strictly apply or something equivalent to it would apply, or some other way of working out the problem that at some agencies don't have administrative law judges, that is also an area of concern.

We think there is clearly a vehicle that we can work with you and your staff on to move forward. We think it would be a very helpful complement to providing a little more integrity to this procurement area.

Chairman Roth. There has been a suggestion that in fact a number of civil settlements have complicated criminal prosecutions.

Would you care to elaborate on that?

Mr. Olsen. There is clearly in this law of the land that they need to maintain a separation between the civil and the criminal processes. We don't ever want to begin to use the criminal process to hold up the contractors.

At the same time, we find that there are cases I know currently pending in the courts involving the utilization of grand jury information once a criminal case is closed.

These are problems that require a delicate balance in terms of how we begin to exchange information. There are some limitations. However, more recently, President Reagan signed into law the Victim and Witness Protection Act, which will provide some cure for this in some of the small areas of the procurement fraud.

It mandates restitution for what are title 18 offenses. The trial court would be obligated and mandated to impose restitution at the time of sentencing upon a showing by a preponderance of the evidence what the loss is.

We, at the Department of Justice, know that as a relatively simple matter to establish since at the time we are going to charge a defendant with a crime we are going to need to know that information to show what the harm was to the United States.

If the defendant does not have the ability to pay, and establish that by a preponderance of the evidence, there will be no imposition of restitution.

This provision, however, won't be available in what we call the larger cases because the statutory framework also limits the imposition of restitution by prohibiting the court from generating unwarranted delays in the sentencing process.

So in large cases, that will not be the vehicle. In other cases, we are working with the Civil Division in the Justice Department to begin to address many of these problems. We also have a Civil Division presence in that fraud procurement unit for the very reason that we raised the question to begin to look at the complement of what is the interrelationship between the loss to the Government if it is not a criminal case and what can we do and what can't we do.

At the same time, we have to work with what we call the Chinese walls of maintaining our separation between the criminal and civil processes.

It is a difficult problem. It is not one that is easily solved.

Chairman ROTH. Senator Stennis.

Senator COCHRAN. I have no questions, Mr. Chairman.

Chairman ROTH. Senator Cochran.

Senator STENNIS. No questions.

Chairman ROTH. This will conclude for today the hearings. I would advise that the subcommittee does intend to continue our investigations in this field and look at other locations.

The record will be kept open for any possible written questions to follow for 2 days.

The subcommittee is in recess.

[Whereupon, at 12:30 p.m., the subcommittee recessed, to reconvene at the call of the Chair.]

APPENDIX

PREPARED STATEMENT OF SENATOR CHARLES H. PERCY

BEFORE THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
HEARING
OVERSIGHT HEARING INTO
FRAUD, WASTE AND ABUSE
IN THE PROCUREMENT OF
NAVY SHIPS

Tuesday, May 3, 1983

Mr. Chairman, as you may know, last week I participated in a press conference with the Better Government Association which focused largely on lavish expenditures made to outfit Navy Ships. Specifically, we cited examples such as the purchase of a $14,000 sectional sofa, a $13,500 bookcase, and a $1,500 portrait. Certainly, the revelation of these expenditures was disturbing, especially in light of the difficult fiscal times our nation is facing.

I have with me today a letter and a telegram from the Department of the Navy which indicate the positive action they have taken to remedy this situation. The letter states that both Secretary Lehman and Admiral Watkins, Chief of Naval Operations, have taken a personal interest in the issue, and a high-ranking Naval officer has assured us that "this type of situation will not be repeated". I am greatly encouraged by the level of concern and action on the part of the Navy.

Mr. Chairman, I applaud your efforts in convening this hearing today. I am well aware of the excellent investigative work which your staff and the Better Government Association have done to prepare for it.

What has been alleged about Ingalls Shipbuilding is certainly disturbing. My staff and I have had several meetings with officials from Litton Industries, the Department of the Navy, and the BGA, and opinions are sharply divided about these allegations. At today's hearing, we need to get to the bottom of this. Our task must not just be to identify problems, but to work towards fair and effective solutions. Many of the problems we will hear about today result from a system that allows -- even encourages -- abuses.

In addition to the concerns that have already been mentioned, I would like to draw attention to two issues which the Better Government Association will bring to light when it presents testimony this morning.

First, the BGA will explain how the Navy, through what is called a "basic ordering agreement", paid $256 for a spare part costing Ingalls Shipbuilding just $11 to buy. This is better than a 2,000 percent markup. Here is the part -- a "gravity timer switch". The switch was not urgently needed by the Navy. The BGA ordered the same switch and paid only $12. As the BGA will testify, this was not an isolated case when it comes to basic ordering agreements (BOA's).

Additionally, the BGA alleges that the Navy, in particular has problems with the disappearance of parts and supplies. For example, the BGA visited a junkyard in Gautier, Mississippi, and purchased an unused valve (still in its original packing crate) which the Navy had allegedly purchased, and then discarded. Although the BGA bought the valve for $70, its book value, according to Navy officials, is $6,500.

From what I understand, these are not hard items to manufacture. The machine tool industry in Illinois is quite versatile, and I have no doubt that dozens of companies in our State would be eager to compete for some of the spare parts business generated by the Defense build-up. Maybe it's time to bring a little more competition into the spare parts business.

The American people have lost their patience for wasteful government spending. No agency or Department is sacred -- the Defense Department cannot be exempt from across-the-board efforts to eliminate wasteful spending. I support a strong national defense. But when we spend a dollar for defense, we had better get a dollar's worth of defense in return.

PREPARED STATEMENT OF SENATOR SAM NUNN

Thank you, Mr. Chairman. With today's hearings, the subcommittee continues its traditional interest in the area of oversight of government agencies and their activities. In particular, our attention turns today to the issue of government contracting in the shipbuilding industry.

I share with you, Mr. Chairman, a concern that American defense dollars be spent in the most prudent and efficient way possible. The oversight role of this subcommittee is designed to help insure that end result. In performing that function, we cannot ignore the large and lucrative area of government contracting. We must assess both the performance obligations of private parties under those contracts as well as the ability of the government agencies involved to effectively monitor that performance.

I understand that today's testimony will largely focus on contract performance at Ingalls Shipyards in Pascagoula, Mississippi. I might point out that the problems which we are concerned with here today are problems which I suspect may be equally relevant at other shipyards and, for that matter, in other industries engaged in government contracting. Resource and time limitations prevent us from today examining in depth contractual performance at other locations. This is not to say, however, that these same problems may not exist elsewhere, and that the lessons gleaned from these hearings should not be heeded elsewhere.

In the past, the subcommittee has pursued its oversight responsibility by assessing the performance of numerous government agencies in a variety of fields, including the enforcement of our narcotics and labor laws, the issuance of federal identification, the enforcement of export controls, the operation of the witness security program, and the administration of the Federal Employees' Workmen's Compensation act, among others.

Today we focus on an area which concerns the adequacy of performance in both the public and private sectors. In looking at the accountability of government contracts, we must by necessity go beyond government performance alone. I understand that we will be hearing testimony from representatives of Ingalls Shipyards, as well as those government agencies involved in the award and monitoring of these contracts, including both the Department of Defense and the Navy. We will, in short, be hearing from all levels in the contractual process. As we have found in the operation of purely governmental programs, I am sure that there are difficulties and problems which can oftentimes jeopardize efficiency in government contracting. Hopefully, today's hearings will shed some light on the nature of those problems and what efforts can be made to solve them in the future.

I know that the majority staff has spent many long hours in preparation for today's hearing and I want to congratulation you, Mr. Chairman, and your staff, for your continuing efforts to insure effiency in government, in the area of defense contracting and elsewhere. We in the Minority look forward to working with you on this and other issues of mutual concern in the future.

PREPARED STATEMENT OF J. TERRENCE BRUNNER, PETER M. MANIKAS AND SUZANNE PETERSEN

BETTER GOVERNMENT ASSOCIATION

Introduction

The Better Government Association (BGA) is a national citizens' watchdog organization dedicated to promoting the efficient use of tax dollars and high standards of public service. The BGA is a private, non-profit non-partisan organization with offices in Chicago, Illinois and Washington, D. C., which often works closely with national and local media to expose waste, inefficiency and corruption and to educate the public about the inner workings of federal, state and local government. Staff of the BGA also work in close cooperation with representatives from government agencies, universities, other public interest organizations, in developing recommendations for reforms to correct the problems uncovered by BGA investigations and research. The BGA has a long and successful history of saving otherwise wasted tax dollars and encouraging an increased measure of accountability and responsiveness from public officials.

The BGA investigation into Navy ship procurement practices at Ingalls Shipbuilding discussed here grew out of an earlier investigation into Public Law 85-804, which permits the President or his designees to modify government contracts when it is determined that it would "facilitate the national defense." In practice, the law had been used by the Defense Department and the military services to rescue companies that made expensive mistakes in meeting the terms of the contracts.

During the extensive research involved with the P. L. 85-804 project the BGA learned a great deal about Navy procurement and the major shipbuilding contractors. The BGA examined the use of P. L. 85-804 in the settlement of shipbuilding claims against the Navy brought by General Dynamics, Tenneco, Inc., Todd Shipyards and Litton Industries.

In the course of our research the BGA came across a false claims suit, Vincent N. Sita, ex rel United States of America vs. Litton Systems, Inc., and CDI Corporation, d/b/a CDI Marine Company, charging fraudulent billing by Ingalls Shipbuilding on

Navy contracts. The complaint alleged that Ingalls was charging the time of engineers working on commercial oil rig contracts to Navy destroyer contracts. The BGA decided to investigate.

The investigation began in early fall 1982. Ingalls and the Justice Department settled the Sita case early in 1983 for about $137,000 before the results of the BGA investigation were revealed. In regard to the Sita case, the FBI and Naval Investigative Service confirmed that sixty-two percent (62%) of the time of a group of engineers was illegally billed to the Navy — charges to Navy contracts for work done on commercial contracts. The BGA investigation described below indicates that mischarging goes far beyond the engineers involved in the Sita case.

BGA staff members spent weeks in Pascagoula and the surrounding area interviewing over 40 current and former Ingalls and Navy employees and others knowledgeable about the operations of the shipyard. In Washington,BGA staff talked with forty additional experts and officials in the course of providing the background research for the investigation and resulting BGA policy recommendations. Hundreds of documents were analyzed during the course of the investigation, including pertinent legislation and regulations, contracts, previous Congressional testimony and reports, invoices and time charging records.

Early in the investigation the BGA brought its preliminary investigative findings to the Senate Permanent Investigations Subcommittee (PSI), which launched its own independent investigation. The BGA also cooperated with CBS' "60 Minutes" which aired an investigative program on Sunday, April 24th concerning some of the findings reported here. The "60 Minutes" program was titled "Dollars Aweigh" and dealt with the issues of irresponsible spending by the Navy to extravagently furnish warships, and deliberate false billing to Navy contracts by Ingalls personnel.

These findings as well as additional examples of waste and inefficiency are described below in detail.

Mischarging - Where Does the Time Go?

The most serious abuse the BGA uncovered at the Pascagoula, Mississippi Shipyard* was mischarging — the practice of billing the Navy for work done on other projects. The BGA's investigation uncovered repeated allegations that Ingalls' management personnel misrepresented labor costs to the Navy by deliberately submitting phony labor charges on government contracts. While it is difficult to put a price tag on mischarging abuses it seems likely that the cost to taxpayers is quite high. Various audit reports, for example, have found that up to fifty-eight percent (58%) of Ingalls' labor charges were incorrectly billed to the government when small samples were involved. Since, as the BGA found, deliberate attempts were made to deceive government auditors it seems likely that the full extent of mischarging will remain unknown. Yet even if the figure is only one percent (1%) of the amount of Ingalls' Navy contracts, mischarging by Ingalls could total about $60 million over the past ten years.

Mischarging not only entails possible criminal conduct and the loss of taxpayer funds; it also destroys the credibility of the cost figures that are used to determine how much national security we are buying for our defense dollars. How much does it cost to build a cruiser or repair a submarine? Unfortunately, we may never know for sure if the bills submitted to the Navy by defense contractors are more fiction than fact.

Mischarging cases seem most likely to occur when a contractor faces large cost overruns on a "fixed-price" contract and is able to shift the cost over to a government "cost-plus" contract which has no firmly fixed ceiling on how much the contractor can be reimbursed. According to Vincent Sita, who sued Ingalls for false claims, that is precisely what happened in Pascagoula when Ingalls charged the Navy for work that was performed on commercial oil rig contracts. According to Sita's civil suit, which was recently settled for slightly over $137,000, Litton experienced substantial cost overruns on its private contracts. Since the commercial contract to construct oil rigs contained a ceiling, Ingalls could not be reimbursed in excess of a preestablished price. To make up for what was being lost on the private contract, Ingalls personnel charged labor costs to contracts that Litton had with the Navy to build four guided missile destroyers (DDG993) and one Spruance class destroyer (DD997).

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*The Shipyard is owned by Ingalls Shipbuilding Division of Litton Industries, Inc.

Early in 1981, Ingalls subcontracted with CDI Marine, a Groton, Connecticut-based engineering firm, for the services of eighteen engineers who were to work on the DDG993 and DD997 projects. While sixty-two percent (62%) of their time was charged to the Navy, most of the work they performed was on the construction of oil drilling platforms.

Ingalls officials concede that mischarging occurred, but they claim it was a mistake. Defense contracting is a complicated business, after all, and time cards sometimes are inadvertently filled out incorrectly. But there seems to be very little that was inadvertent here. An engineer at Ingalls, for example, states that he was instructed by his supervisor to keep two sets of records. When DCAA auditors showed up, he would then be able to claim he was working on Navy contracts when, in fact, his time was being spent on the oil rigs. He was also warned in advance as to when the government auditors would arrive. According to a former section-manager, the mischarging had been planned by the Manager of Engineering Administration and others from the very beginning. When the order for the CDI Marine engineers went out, it was clear from discussions around the office that their work was going to be charged to the Navy, although most of their actual work would be performed on the oil rigs. As a result, the section-manager refused to sign the "delivery requests"; he simply did not want to be implicated in a scheme that looked to him like fraud.

In April, 1983 the Department of Justice settled the false claims action involving the CDI Marine engineers. A criminal investigation into the matter, the BGA has been told, has been launched by the Department of Justice.

After the suit by Vincent Sita was filed, other evidence emerged indicating that this mischarging was not an isolated incident. The BGA learned that work being performed on the commercial oil rig contracts was also improperly charged to the Ticonderoga and other guided missile cruisers (CG 47, 48, 49 and 50). One supervisor at Ingalls told the BGA that he would collect blank time cards from employees and fill them in — not according to the work that was actually performed, but rather according to pre-planned time sheets that were prepared months in advance, and sent to him by a higher-ranking manager. The supervisor, for example, said that he was instructed how to fill in the time cards by a superior's secretary. The secretary would also call to notify employees when DCAA auditors were scheduled to visit. Other employees told the BGA they were expected to lie about the work they were doing in order to ensure that what they told the auditors conformed to what was on the time cards. When DCAA did learn that work was being charged to the Navy on the basis of a pre-planned schedule, an Ingalls' supervisor reports that he was told to destroy the monthly time sheets. Ingalls' employees against whom these charges have been made have denied them.

The mischarging allegations were repeated by other Ingalls' employees. R.J. Primeaux, for example, who worksin Ingalls materials division, was willing to sign an affidavit that stated:

> I was never asked by Ingalls Management to account for my time during each week, and I never maintained a time book or a time sheet. All charge numbers and other data were present on the time card I signed... On information and belief, I was aware that some of my co-workers were being charged to government contracts when, in fact, they worked on commercial contracts. Also, I was aware of persons charged to commercial contracts who actually worked on government contracts.

In June of 1982, a DCAA audit confirmed that mischarging occurred, and found a fifty-eight percent (58%) error rate resulting from a "pre-planned charging schedule." DCAA called the practice "invalid" and "unacceptable". "In our opinion", DCAA's report went on to note, "the use of such a time keeping practice completely destroys the credibility of any cost data applicable to the organization using it."

In March of 1983, ten months after the first audit was conducted, the BGA and CBS "Sixty Minutes" made a formal request to DCAA asking if a followup audit had been conducted. DCAA responded that although no follow-up audit was needed they had reexamined the issue. But now the auditors seem to have retreated from their original findings. DCAA stated that the reexamination took place to prevent the original report from being "misunderstood, misused or construed as representative in any way of the contractors overall time keeping system." Coming to Ingalls defense, DCAA now says 1.) they discovered no other evidence of mischarging in previous audits (floorchecks) over the past two years; 2.) that not all of the mischarging found in this instance was to the government — that is; government work was also mischarged to private contracts; and 3.) no cost adjustment could be made because they are "difficult, if not impossible" to make, and must be justified by "extraordinary circumstances."

Nevertheless, there were several indications that the work being done at the shipyard was highly vulnerable to fraud and abuse; a follow-up audit, more comprehensive in scope, should have followed. While previous floorchecks may not have revealed other instances of mischarging, there were other reasons for suspicion. The civil false claims action involving the CDI Marine engineers, for example, was pending. Moreover, DCAA itself in June of 1981 had found that a form of mischarging had occurred.

This DCAA audit found Ingalls failed to comply with proper accounting practices because of "numerous instances where employees classified as 'direct' (and charged to contracts) did not meet Ingalls' definition of a direct cost"; that is, their time "could not be economically or consistently identified to specific contracts." The audit looked at the Engineering, Operations, and Material divisions of Ingalls and found inappropriate and arbitrary time charging practices. The auditors found several examples where the time of clerical workers, managers and section managers, general foremen and foremen was charged to government contracts even though they were also working on commercial contracts. The auditors noted that only two percent (2%) of the Engineering division employes were classified as indirect and commented, "an indirect manning rate of 2% is almost inconceivable especially considering that Ingalls has over fifty different Navy and Commercial contracts identified in its "General Ledger".

The auditors did not attempt to determine the cost impact on government contracts but stated, "In view of the potentially large number of employees involved in the noncompliance, we believe that the cost impacts could be significant." In 1981 Ingalls agreed to conduct a feasibility study, to be coordinated with the government, for establishing new accounting procedures for allocating support functions. We found no indication, however, that the study was ever completed.

Not all the mischarging that takes place is directed at the government. As the Primeaux affidavit states, for example, labor was sometimes charged to commercial contracts when work was actually done on government contracts. The BGA, of course, does not have access through the Freedom of Information Act to the contractor's records on private contracts; consequently, we are not able to confirm the extent to which mischarging also occurred on commercial contracts. However, regarding Ingalls' contracts with the Navy, the BGA did learn that: (1) mischarging did occur and it was both deliberate and planned, at least at the supervisory level; (2) supervisory level officials at Ingalls instructed employees to deceive DCAA auditors by keeping phony sets of documents, lying and even destroying documents; (3) Ingalls' employees were sometimes given advance notice by supervisors as to when auditors were scheduled to visit for the purpose of deceiving them.

In addition to the mischarging between government and private contracts, the BGA also uncovered mischarging from one government contract to another. One such story was told to the BGA by Don Sigalas, a planner responsible for scheduling tests on the Navy's nuclear submarines brought to the Pascagoula Shipyard for overhaul. He charges that while he worked only on the Tinosa (hull 1210), his time cards were filled out for the Shark (hull 1209), Gato (hull 1212) and Sunfish (hull 1213). Sigalas was aware that intentionally submitting false labor charges to the Navy was fraud and in late 1977 he started refusing to sign the time cards. Sigalas says that he complained to others at Ingalls about what was going on, including the director of submarine projects and later to Ingalls' attorney. Yet no action by Ingalls' officials was taken.

Sharon Sigalas, Don's wife, also worked at Ingalls. It was her responsibility to juggle the time by looking at computer printouts of money left in contracts, to fill out the time accordingly for thirty or forty people, and to get the workers to sign the cards. She eventually ran into resistance from Don Sigalas and began to question the practice herself.

Sharon Sigalas states that it was her job to fill out time cards, often incorrectly, and to collect signatures from the workers. According to Ms. Sigalas, her supervisor told her to "go light on 1210," meaning that labor time spent on that hull should actually be charged to other hulls. She was instructed to charge the work to hull 1209; although the ship was already out of the yard, there were funds remaining in the contract. Later, 1210 work was also charged to the 1212 and 1213. The purpose she learned, was to make the 1210 hull contract look good so Ingalls would get future submarine overhaul contracts.

When Sharon Sigalas complained about the mischarging practice to her supervisor, he relieved her of the duty; but, according to Ms. Sigalas, he soon tired of doing the paperwork himself and she had to reassume responsibility for the mischarging in order to keep her job. Sharon Sigalas left her job voluntarily in November of 1978. Don Sigalas was fired because, he contends, of his pressing the mischarging issue.

[illegible]

[illegible]

[illegible]

[illegible]

Habitability Improvements — The Navy's "Love Boats"

Perhaps the most graphic examples of waste and extravagance uncovered in the BGA investigation concern "habitability improvements" made in some of the Navy's newest warships. While everyone agrees that our Navy ships should be habitable to enable them to remain at sea for long periods of time, the Navy has gone "overboard". The BGA learned that standard furnishings were being replaced by highly-priced custom-made furniture in order to satisfy the interior decorating demands of high-ranking Naval officers.

For example: the Captain's Wardroom of the USS Kidd (DDG 993), built by Ingalls, was outfitted by Litton Office Products with a custom-made leather sectional sofa, and a custom-made Chippendale-type sofa and wingback chair for $18,000. The Kidd also received five custom-made brass end tables, for which the Navy paid $6,500, and wool carpeting for $41,071. The cost of the carpet alone was $25,440 ($57 a yard) but Litton Office Products' invoices show that approximately $15,600 was added by Litton for installation and administration to bring the total cost to $93 a yard.

Another example: the USS Callaghan (DDG 994) received a $14,000 custom-made leather sofa, a $13,500 custom-made combination bookcase, planter (including plants and grow light), television and storage cabinet ("Design to be approved by Captain before assembly"), and three lamps for the lounge area (one was an elephant sculpture) for $800. The Callaghan also boasts silk flowers costing $250, according to purchase order invoices.

Items like the fancy furniture on the Kidd and Callaghan are part of what is called "habitability improvements" or "post-shakedown availability (PSA) items," and they can be added to a ship up to a year after it is delivered. Many times the habitability improvements are made when detailed finishing work on the living quarters is not completed when the ship is delivered; however, the BGA was told there is a lot of competition between ship commanders and, particularly when there is money left at the end of a contract, they try to "grap all the gusto they can get." This has included reupholstering brand new furniture or changing the carpet when a Captain doesn't like the color.

The USS Fletcher (DD 992) is another example; it was delivered in September, 1980 and in approximately March, 1981 work on habitability improvements began. For the Wardroom, Litton Office Products provided the labor and materials to reupholster four lounge chairs in "grey brown" for $1,560. Two barrel chairs were reupholstered in "chocolate" for $850. And, in the Captain's Stateroom two lounge chairs were reupholstered in "grey" for $890, one three-seater was reupholstered in "pewter" for $295. To roundout the color scheme, Litton provided materials and labor to make a "pearl-colored" bedspread for $200 and carpeted the stateroom in "paprika velour" for $2,186. Oriental print draperies with a border and vase pattern and white lining for $650 complete the effect.

The habitability improvements are approved in Washington and contract administrators in Pascagoula do not feel they have much authority to resist, the BGA was told. Due to the limited availability of the ships, there is no time to seek competitive bidding on the work. The job is given to Litton Office Products, a division of Litton Industries. An undated memo from a contract administrator, Don Slider, documents the problem of extravagance from the perspective of SupShip Pascagoula.

Slider looked at the USS Fletcher, Kidd, Callaghan and Scott and found that "the basis for these so-called 'habitability' charges appears to be the fact that the standard furnishings provided for the specified area lack the aesthetic appeal required to satisfy the occupants of the areas." He described the way habitability improvements are made:

> A meeting is arranged by ISD (Ingalls Shipbuilding Division) with the ship's Captain and Litton Office Products (Mrs. Wright) to discuss furnishing for the specified areas. At this time the amount of money available for the job is revealed. Further discussions ensue in which the Captain indicates what his desires are and Litton then proceeds to provide estimates, samples and suggestions on how to obtain what is desired and remain within the budget limitation. Each item is subject to the approval of the ship's Captain. In many instances the furnishings must be custom made, such as brass coffee tables and custom made couches with metal frames, fire-retardant padding and leather upholstery. To meet ship safety requirements special anchors have to be attached to fasten furnishings to the deck. All these items are made from the highest quality materials and manufactured to exact specifications by experienced craftsmen. Ships are in the yard only durin, restricted availability and due to the extremely limited time available for the purchase/manufacture and installations of these furnishings, no attempt at obtaining competitive bids or quotes is made. Litton Office Systems relies upon their experience in this area to obtain the best service possible under the circumstances, with primary emphasis placed on providing the items desired in the required time frame, with cost being a secondary factor.

Slider concluded that "the only solution appears to be action taken by NAVSEA to establish standards for furnishings and adhere strictly to the standards."

Recent habitability improvements on the Ticonderoga, (CG 47), seem to indicate that the extravagant practices did not stop as a result of the Slider memo. The Ticonderoga was delivered on December 13, 1982. Arrangements for habitability improvements began in the summer and fall of 1982. A September 2, 1982 letter from Ingalls CG contract manager, D.W. Sharer, to Commander Harris, SupShip Pascagoula, documents an agreement for a $41,889 "Wardroom Habitability Upgrade" for the CG 47. "This change proposes to remove existing furniture items from the wardroom and replace with new furniture items to be furnished by Litton Office Products Center. This proposal is based on products, materials, finishes and colors selected and approved by CG 47 Prospective Commanding Officer, Captain Guilbault and CG 47 Supply Officer LCDR Smith." Additional contract modifications for habitability improvements of the Captain's Stateroom and SeaCabin, and to various crew areas ultimately totaled $89,359, and some of the work involved removing furniture already installed and reupholstery for a ship that was not yet delivered.

As a result of the attention focused on the problem by our investigation, Admiral Fowler, Naval Sea Systems Command, issued a directive on March 24, 1983 which stated that furniture will no longer be replaced for solely aesthetic reasons.

Basic Ordering Agreements (BOA's) - The Need for BOA Constricters

Another area of shipbuilding waste uncovered by the BGA involved the use of Basic Ordering Agreements (BOA's). The agreements, which enable the contractor to purchase items for the Navy, are used because they are supposedly efficient and convenient. However, the BGA's investigation revealed that BOA's sometimes result in the Navy paying highly inflated prices without getting prompt delivery.

The Navy will secure a BOA with a contractor to expedite procurement where specific items, quantities and prices are not known at the time of execution of the agreement, but where future plans indicate that a substantial number of requirements for items will result in procurements. BOA's can substantially shorten the time required for procuring items and thus allow urgently needed items to be obtained quickly. In return for obtaining items quickly, the contractor can add a surcharge to the cost of the item to defray the expense involved in responding to the BOA orders. The amount of the surcharge or the method of determining it is agreed upon between the Navy and the contractor.

The BGA examined one agreement (BOA no. N00104-77-A-0102) which allowed the Navy or any DOD contracting officer to order "spare and repair parts, assemblies, modification kits, special tools and such other supplies as available from Ingalls Shipbuilding Division." That agreement revealed the BOA did not expedite procurement. Instead, it resulted in the Navy paying highly inflated prices for equipment that was not urgently needed by the Navy, or not promptly delivered by Ingalls. In fact, the material ordered from Ingalls under the BOA could have been obtained as quickly by the Navy itself. Not only did this BOA fail to meet its stated objective, but according to a Naval Audit Service report, it resulted in unduly restricting competition. In short, the BOA was abused.

One example of the abuse involves the purchase of a gravity timer switch by Ingalls for the Navy. The switch is part of a gravity timer assembly for "water closets" on Navy vessels. On September 22, 1978, Navy Ship Parts Control Center (SPCC) ordered from Ingalls Shipbuilding a gravity timerswitch for the USS Jason (AR8), a supply ship. The Navy paid $256 to Ingalls for the switch; the cost to Ingalls was $11.

Although the Navy paid the 2,227% increase in price, apparently it did not urgently need the switch. The order was initiated in September, 1978 but delivery was not requested until January, 1979. Ingalls shipped the switch to Superintendent of Shipbuilding (SupShip) in Pascagoula in November, 1978. Final delivery was not completed until February, 1979, five months after the order was placed.

In the meantime, Ingalls ordered a replacement for the switch from Jered Industries in Birmingham, Michigan, the sole manufacturer of the switch. Ingalls paid $11 for it and received the replacement in just two months. The BGA ordered eight gravity timer switches from Jered in September, 1982, paid $12 per switch and received them in approximately one month.

Ms. Mickey Fedorko, manager at Jered's repair parts facility, said the company regularly sells their products directly to the Navy and other government agencies.

The high cost and lack of efficiency associated with the BOA the BGA examined also drew the ire of SupShip, Pascagoula contract administrators Patty Smith and America Collins. They cited the case of Delivery Order 3051 issued by SPCC to Ingalls on July 15, 1979. The order was for "transducers" for the Spruance class destroyers. Transducers measure physical variables, such as pressure, and translate them into electrical signals. Delivery was requested on October 13, 1979. Ingalls ordered the transducers from Kulite Semiconductor Products, Inc., paid $420 apiece for them, delivered them on November 30, 1979 and charged the Navy $634 each.

In an October 1979 "Beneficial Suggestion," Smith and Collins were highly critical of the BOA's with Ingalls Shipbuilding Division. They said the BOA's made sense only when Ingalls had production assets or excess material in-yard to assist an operating vessel in the fleet that was crippled due to lack of material. However, Smith and Collins citing Ingalls' past performance, said that out of 72 orders issued to Ingalls for repair of destroyers* and Landing Helicopter Assault class ships, Ingalls subcontracted the repair in all but two cases:

> In many—perhaps most—cases, Ingalls will receive an order from SPCC, will place a purchase order to the manufacturer or a jobber, and will provide the material to the Navy once it is received from the manufacturer. Ingalls applies labor hours, overhead G&A, proposal preparation hours, profit, etc., to the purchase order price; and the Navy ends up paying about 30% over the purchase order price without getting the benefit of even a better delivery date.

Smith and Collins suggested that SupShip Pascagoula "source" the material for SPCC so that SPCC could order directly needed material and repairs with resulting "cost saving and better delivery." The Beneficial Suggestion was forwarded to SPCC; but misuse of the BOA was discovered again in 1981.

This time the misuse involved restricted competition and the acceleration of costs by more than thirty percent (30%) for the services of the contractor. The misuse was documented by the Naval Audit Service (NAS), which revealed in a July 16, 1982 report that invalid orders were being placed under the N00104-77-A-0102 BOA with Ingalls. The report stated, "A BOA is being improperly used to obtain procurement services from ISD." The most outrageous example cited in the audit involved a $21,797 bill presented to the Navy by the contractor for simply requesting, by telephone, that the third party manufacturer deliver the required item . . .to the requesting activity." That's an expensive way to reach out and touch.

SPCC in a response contained in Navy audit reports, admitted that "the BOA did

*BOA #N00104-77-A-0102 (this is the same BOA referred to earlier).

not envision placing either routine or urgent requirements with Ingalls for material which could be obtained at lower cost from actual or original equipment manufacturers within required delivery times." SPCC examined 15 files and concluded "While the review indicated that the provisions of the BOA are being followed [by SPCC], it also evidenced a need for improved order file documentation particularly to more clearly reflect prices, delivery times, etc., quoted by firms other than Ingalls." It should be noted that the SPCC review was narrow in scope and did not include SupShip Pascagoula or other contracting offices placing orders under this BOA.

Responding to protests by private companies that BOA's restricted competition, the Comptroller General of the United States issued several decisions which point to misuse of the BOA system by the Navy. A December 13, 1978 decision found that the Navy's use of a BOA to procure aircraft parts was "unduly restrictive of competition" and recommended to the Navy that "procedures for effectively qualifying alternate suppliers, including surplus dealers, be established and implemented, that synopsizing procedure be amended to provide notice requisite to allow and encourage competition for future parts procurements, and that basic ordering agreements be used in a manner consistent with the regulatory requirements."

Again on October 14, 1980, the Comptroller General decided that a BOA was improperly used in a manner restricting competition relative to procurement of "mechanical seal conversion kits." The decision states that the Comptroller sent a letter "informing the Secretary of the Navy of the defects in this procurement and requesting that action be taken to assure that these defects do not arise another time."

A year later, the Comptroller General expressed concern that the Navy may be failing to obtain or develop data needed to solicit competition for requirements under BOA's. While the Comptroller General did not find evidence of restricted competition following a company's protest of a particular BOA regarding placement parts, it did encourage the Navy to solicit competition. "There is nothing in the record to show that the Navy has attempted to obtain data from Worthington during the past four years in which over 200 noncompetitive orders have been placed with Worthington. In order to maximize competition we are suggesting to the Secretary of the Navy that this avenue be explored."

While reducing competition, BOA's also reduce the contractor's risk. A recent Air Force study chided the Air Force's use of a Navy BOA which allowed the contractor to reprice parts at, or in some instances, after delivery on the basis of incurred costs plus profit. The study said the BOA was the major culprit behind a 300% cost increase on 34 spare parts furnished to the Air Force by Pratt & Whitney, a major Air Force contractor. The cost increase resulted in an additional $140 million in repricing.

The BOA provided no incentive for Pratt & Whitney either to (a) control and reduce costs or (b) meet or exceed delivery schedules, the report concluded. It recommended the Air Force terminate use of the Navy BOA as rapidly as feasible and establish prices with meaningful competition and/or analysis of what products should cost under conditions of efficient procurement.

The Air Force study, the audits and inquiries of various government agencies and the BGA investigation discussed above all point out substantial problems with the BOA procurement process. The Navy is paying far more than is necessary for many routine materials. It is paying highly inflated prices for material not urgently needed or promptly delivered. BOA's provide little incentive for contractors to keep costs down but every incentive to restrict competition.

Yet, despite these problems, no government agency has made a comprehensive analysis of the problem. A GAO shipbuilding expert, Sidney Wolin, told the BGA that there are many different methodologies used to establish BOA's and that almost no one has expertise in the issue.

Discarding Shipbuilding Material - "Heave Ho"

Defense procurement official Ernest Fitzgerald told the BGA, "it's difficult to steal money from the government but it's child play to steal material." Referrals to the Justice Department, Naval Audit Service (NAS) reports, and Naval Investigative Service (NIS) investigations, all indicate that the Navy in particular has problems with material management and the disappearance of material. The BGA investigation of Navy ship procurement from Ingalls Shipbuilding also turned up evidence of poor material management.

Early in the investigation the BGA was told about a scrapyard in Gautier, Mississippi, near Pascagoula, where one could buy unused Navy machine parts and supplies. These rumors even indicated that parts could be ordered from the Ingalls' yard and it would be out at the scrapyard in a couple of days.

BGA investigators visited the Sanitary Landfill Co. in Gautier, and bought two pieces of valuable unused equipment. The first was a valve, still in its packing crate, used to control the flow of fuel on Navy ships including the landing Helicopter Assault Ships. BGA investigators paid $70 for it, but according to Navy officials, the current book price for this valve is $6,500. When shown this valve, Joe Brown, the Navy's civilian property manager (now retired), was appalled to learn that the BGA purchased it at the scrapyard. He said, "Don't tell me you bought this at that junkyard." Brown's subsequent attempts to trace the valve's history were fruitless. His review of Navy and Ingalls records did not reveal when or where the valve was purchased, or when or if anyone ever realized it was missing. Brown was certain, however, that the Navy had paid for the valve.

The second piece of equipment was a differential pressure indicator (gauge) used to measure pressure. The BGA paid $8 for it; the manufacturer says the current price of the gauge is $550. The gauge was one of thirty sold to Ingalls in 1975 under the Spruance class destroyer contract, according to Ed Zepeda of ITT Barton, the

California company which manufactured it. According to SupShip personnel, the Navy would have reimbursed Ingalls for the purchase. Because this part still has the green tag attached by the manufacturer it is safe to infer it has never been used, according to Zepeda. It might need new "O-Rings" because of its age but it most assuredly works, he said.

Ernest Applewhite is the owner of Sanitary Landfill in Gautier. Waste Management Inc. of Oakbrook, Illinois, a major waste disposal firm, contracts with Ingalls to haul out the trash. Ingalls pays this firm by the cubic yard of trash and Waste Management pays Sanitary Landfill to take the trash, according to Applewhite.

This yard is full of material used in shipbuilding, most of which Applewhite says he buys as scrap or surplus in a legitimate bidding process. Sanitary Landfill is regularly visited by Navy and Ingalls officials looking for irregularities according to Applewhite. But he cannot explain why valuable items like the valve and gauge end up at his landfill. Trash is just solid waste (except sometimes valuable items get in there, according to Applewhite). He speculates that is how the valve found its way to his junkyard; it was accidentally thrown in the trash. The gauge, he theorized, came in a lot of stainless scrap steel he purchased from Ingalls.

Although the BGA could not determine if the purchased valve and gauge were stolen or lost, it is clear that the disappearance of valuable material is a significant Navy problem — a problem also known to suppliers. Zepeda almost immediately determined how we purchased the valve. He said, "it sounds like somebody paid $550 originally and somebody else bought it for $10." ITT Barton had done enough work with the government to know about how valuable material ends up in the scrapyards. At one time the problem was so bad in their area that ITT Barton sent their customer relations personnel to buy back their parts from scrap dealers.

Government reports further document the problem.

Since 1978 there have been ten significant referrals from DOD to Justice for prosecution regarding the theft or misuse of government material, as reported in the semiannual Reports to Congress on Audit, Inspection and Investigative Operations in the Department of Defense. All of these cases were from the Navy. One involved an estimated monetary loss to the government of over $1 million.

The Naval Audit Service (NAS) has documented problems with property and material administration at SupShip Pascagoula beginning at least in 1979. Their reports indicate that poor property and material administration have led to inefficiency and a loss of accountability. A 1979 report indicated that Government furnished property (GFP)* in possession of the contractor (Ingalls Shipbuilding Division) was not being administered by SupShip in accordance with Defense Acquisition Regulations. NAS offered some specific criticisms of SupShip concerning the $125 million of GFP in possession of the contractor:

1. No property systems survey plan has been developed nor are annual surveys being conducted against certain contracts;
2. ISD is not returning contractor acquired property to vendors for credit at contract completion, as required;
3. Government furnished property at off-site locations was not properly monitored and periodic inventories were not performed.

The SupShip and NAVSEA responded that formal surveys would begin, the contractor would be encouraged to return material and the off-site locations were being closed down.

In 1982 when another audit of SupShip Pascagoula was issued, the NAS reported that government furnished material was procured under the long lead time material authority for the DD 963 overhauls that should have been provided by the contractor. Further, some of the government furnished material was procured under "false urgency"

*Government Furnished Property (GFP) is purchased by the government and supplied to the contractor. Contractor Furnished Property (CFP) is purchased directly by the contractor and charged to the government under the contract.

requisitions and it arrived long before it was needed (similar findings were made in the 1979 audit). These "expedited shipments" added unnecessary transportation costs and some items were delivered within 1 to 6 days but kept in storage for 202 to 204 days. This report also noted that the value of government furnished material in possession of the contractor was $750 million, risen from $125 million in 1979.

Material procured and stocked in the shipyard so far in advance becomes vulnerable to loss. Whenever government material is lost or stolen in Pascagoula, the Naval Investigative Service (NIS) is charged with investigating its disappearance. NIS reports requested under the Freedom of Information Act indicate:

> Material ordered far in advance and delivered to the worksite cannot be accounted for; and
>
> Due to the substantial amounts of material and large amounts of scrap and trash generated, valuable items can be accidentally thrown away.

NIS investigators often cannot even determine if material is lost or stolen.

The following two reports taken from NIS agents' notes are illustrative:

7-23-82

> Ingalls Shipbuilding Division, (ISD), reported to Supervisor of Shipbuilding Conversion and Repair, US Navy, Pascagoula, MS, that another signal conditioner (serial number unknown), was missing . . .Material was delivered to the work craft on 14 Oct 81 . . .When the signal conditioner was sought for installation around 10 Jun 82, it could not be found . . .Accountability of the material is made until it is issued to the work craft for installation. At that point accountability is lost. There exists too long a time frame between the craft receiving the material and installing it aboard the ship. There also exists poor physical security of the material at that point. Investigation is closed due to the lack of substantive leads . . .Loss of government property $1,225.00;

5-21-82

> Based upon joint Naval Investigative Service and Ingalls Shipbuilding Division (ISD) investigations department efforts in interdicting the improper movement and disposal of government furnished materials/equipment from ISD facilities, four nickel-copper pipes valued totally at $2,000 were recovered from the ISD resource recovery site prior to their removal from the site in scrap trucks. . .the pipes were government furnished material and total recovery value was $2,000. . .Due to the large generation of trash and scrap within the ISD facility and the unrestricted access to the trash and scrap containers dotted throughout the facility, no suspects could be developed.

Joe Brown told the BGA that the government material in the Ingalls Shipyard is out of control. He indicated that the value of the government material in the yard was $1.3 billion, and he, with his seven assistants, could not keep track of such a large volume of material.

Oversight of the Navy's Procurement Process

Several agencies have responsibility for ensuring that the Navy's funds are spent efficiently and that losses through fraud are held to a minimum. Within the Defense Department, for example, the Defense Contract Audit Agency (DCAA) is in charge of monitoring the work of private contractors. The Naval Investigative Service (NIS) has the responsibility for investigating criminal wrongdoing in that service. The Inspector General of the Defense Department does not have line authority over all the Department's audit and investigative units but the IG is to provide them policy guidance and oversight. Additionally, the Defense Audit Service (DAS) and the Defense Criminal Investigative Service (DCIS) are now directly under the supervision of the DOD Inspector General's office.

Other government agencies, of course, also perform important roles in conducting oversight. The Navy's Office of General Counsel has the responsibility for taking action when a contractor is to be debarred or suspended. The Department of Justice also investigates and prosecutes cases of criminal wrongdoing.

In total, DOD employs about 18 thousand investigators and auditors in 13 various agencies. Their combined budgets amount to one-half billion dollars. Yet, despite this vast array of auditing, investigating and enforcement agencies, effective oversight of Naval operations, particularly in the area of procurement, is lacking. The major findings regarding oversight of the Navy's activities are set out below.

Defense Contract Audit Agency (DCAA)

During the course of the BOR's investigation, we repeatedly heard charges that DCAA auditors, while well-meaning and hard-working, simply lacked the special training and competence to effectively detect and investigate sophisticated fraud. In fact, DCAA's mission, as defined in policy directives since the early 1970's, seems to conflict with that role. In an effort to avoid the creation of an "adversarial

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

DCAA's referral rate was .08 percent (.08%). In contrast, the General Services Administration contract audit referral rate was 3.3 percent (3.3%) — or forty-two times greater than DCAA's.

The BGA's investigation indicated that when significant findings are disclosed by a contract audit, they sometimes die with the issuance of that report. For example, even with all the existing warning indicators of labor cost mischarging in Pascagoula (a criminal indictment and a civil false claims action were then pending against Litton) the DCAA did not conduct a follow-up audit when a floorcheck revealed that 58 percent of a small sample of labor charges in the materials section had been mischarged to the Navy. A few years before, there was apparently no effective follow-up when DCAA auditors found that Litton had improperly charged indirect costs directly to the Navy. GAO's 1979 finding that DCAA "does not adequately follow-up on reports it issues" appears still to be true today.

Naval Investigative Service (NIS)

The Naval Investigative Service (NIS) reports to the Naval Intelligence Command which in turn reports to the Chief of Naval Operations. NIS has responsibility for criminal investigations involving counterintelligence, the Uniform Code of Military Justice and other federal law. Because of its responsibility for enforcing the military code, NIS has focused much its attention on street crime, for example: drugs, homicides, and other crimes against the person.

Naval review agencies are maintained as separate entities consistent with DOD's concept of military command management; the audit, inspection and investigative units are intended to compliment the chain of command. As summarized in a 1980 DOD task force report, "responsibility for effective operations rests upon and is personalized in commanders at all levels." They "have primary responsibility for preventing waste, fraud and abuse."

The procedures required by the Navy chain of command in a criminal fraud investigation are, at the very least, cumbersome and lend themselves to "the possibility that undue deference is given to the wishes of the 'Base Commander,'" as the Justice Department commented in 1978. Almost all NIS fraud investigations are initiated by a commanding officer because it is Navy practice to solicit command requests. Even if an NIS investigation receives a "hotline" tip and makes an initial determination to pursue a case, the commander is informed and asked to request an investigation. Naval Audit Service auditors encountering suspected fraud simultaneously send reports to the affected commander and NIS. Again, the commander must be solicited for his request and he also must be briefed during the course of any investigation.

The BGA did not in the course of its study encounter any situations where a commander had prevented an investigation. However, the GAO in a recent report* disclosed that an Air Force commander had in fact thwarted a fraud investigation. The GAO also commented, "This matter illustrates how serious fraud allegations can be ignored when fraud investigators defer to a commanding officer's decision."

According to a recent GAO study, sixty-two percent (62%) of DOD's criminal investigators' fraud caseloads involve losses of five hundred dollars or less; only four percent (4%) involve losses of $5,000 or more. One reason the investigators focus on small scale fraud is because their investigations result from referrals by commanding officers, the study said. Also, according to GAO's study, NIS views itself as a "service" organization and responds to the immediate concerns of commanders. Little or no attempt is made to screen cases to ensure that the most significant are given priority.

The BGA's investigation revealed another shortcoming at NIS. In December of 1980 a former Ingalls' writer/editor who had been fired by the firm sent a mailgram to the President of Ingalls with a copy to SupShip. He charged, among other things, that Ingalls submitted false time reports to the Navy and diverted funds earmarked for a CG 47 change program and that the company failed to generate a useful product

*GAO/AFMD-83-33, March 21, 1983.

in the Design Engineering writing section. The firm performed an initial audit in January of 1981 which concluded that the allegations were without substance. This audit "initially satisfied SupShip" according to the investigative report, but a year later NIS was requested to interview the individual who sent the mailgram. SupShip apparently requested this as a follow-up to determine if the sender had any substantiating documentation. An interview was conducted but the individual had no substantiating documentation at that time, and the SupShip Counsel's office "advised" that this, "would conclude the matter."

Based on the facts as recorded, it is impossible to determine if the allegations were accurate; however, two important issues are immediately apparent. First, although Navy regulations require that commanding officers refer incidents of "actual suspected, or alleged major criminal offense," of which they are cognizant, over a year passed before the SupShip directed the NIS to investigate these allegations. If Navy procedures are not followed, should a commander unilaterally determine when and if an investigation is to be conducted? The investigative trail obviously becomes more difficult to piece together as time passes.

Second, it seems highly inappropriate for the Navy to request that a contractor review charges of fraud allegedly perpetrated by the contractor. The Navy, in effect, asked the contractor to investigate itself. Once the investigation was referred, NIS should have taken the extra step and requested a government audit. There is nothing in the record to indicate that the DCAA was even consulted.

Oversight Through Contract Management

One method of contract oversight is through the use of incentive contracting, which provides the government with criteria to judge the contractors work. However, we found the use of two types of incentive contracts with Ingalls, the cost-plus-incentive fee (CPIF) and cost-plus award fee (CPAF) did not provide adequate oversight.

The incentive fee contracts were used on the submarine overhauls, the guided missile destroyer (DDG 993) and one Spruance class destroyer (CDP 997). These contracts provide for a fee which is adjusted by a formula set out in the contract. The formula provides for increased payments to the contractor if, at the end of project, the total costs are lower than target costs specified in the contract. Conversely, if the total costs are higher, the contractor will lose money. The provision for increase or decrease in the fee is designed to provide an incentive for maximum effort on the part of the contractor to manage the contract efficiently.

However, the CPIF contracts we examined were ineffective in holding down costs due to their constant modification. The modifications raised the target costs, making it difficult to control them. Once the submarine contracts were converted to CPIF contracts, numerous modifications resulted in increasing the contract costs an average of $25 million per vessel. The adjustments resulted from the Navy changing its specifications over the life of the contract as well as cost overruns on the part of the contractor. In fact, the cost overruns on the submarines were so severe and the delays were so long the Navy discontinued use of Ingalls for its overhauls. When the target costs are continuously raised, the incentive for efficient contract management is lost. In essence, the contracts become difficult to monitor when there are moving targets.

Award fee contracts use subjective criteria to evaluate a contractor's performance. The criteria is used by an awards fee committee to determine how much money should be given to the contractor as an award for good performance. These contracts, used with the $1 billion Aegis-class cruisers, pose problems when the contractors participate in the deliberations which determine their award. When the contractors actively participate in their fee determination, as Navy policy allows, an appearance of impropriety results and the fee determination itself can be called into question.

CPAF's provide an award sufficient to spark motivation for excellence in contract performance in areas such as quality, timeliness, ingenuity and cost effectiveness. The amount is based upon a subjective evaluation by the Government on the quality of the contractor's work. According to Defense Acquisition Regulations, the decision that an award fee has been earned is based on the reports of performance made by Government personnel knowledgeable with respect to the contract requirements. While the government should be as informed as possible in making that decision, participation by the contractor in the decisionmaking process suggests impropriety.

However, according to the NAVSEA Contract Office, it is Naval policy to allow the contractor to participate in the deliberations of the award fee committee. According to NAVSEA, the contractor is allowed one non-voting member of the committee, who sits in on all its meetings, to cross-examine witnesses and listen to all deliberations.

This is in sharp contrast to the policies of other federal agencies which utilize award fee contracts. According to a NASA official,[*] their relationship with the contractor is quite formal. The dealings are at arm's length. One NASA official said that while the contractor may rebut the findings of the award committee through a written or oral presentation, the contractor does not participate in the deliberations.

The Department of Energy (DOE), also maintains a more formal relationship with the contractor. According to DOE's Director of Procurement Policy,[**] the contractor is never involved in the deliberations. "They don't sit across the table and negotiate with us. We make the decision behind closed doors. We communicate the decision in a formal way. They are not involved in the process."

A management professor at the State University of New York[***] who served as a consultant to NASA on incentive contracting told the BGA that while the award fee committee must accumulate as much information as possible in making the fee determination, the award fee must be a government decision. "It would be inappropriate for the contractor to participate."

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[*] Telephone interview with Mr. Joseph Garcia, Director, Contracts Operations Division.

[**] Telephone interview with Mr. Edward Cumesty.

[***] Dr. Raymond Hunt has conducted research into the effectiveness of cost-plus-award fee contracting over the past 15 years.

Enforcement Against Private Contractors

In addition to the seemingly inappropriate arrangement between the Navy and contractors, the Department is reluctant to take administrative action against contractors who mischarge. According to a lawyer for the Navy's general counsel[*] "there is a strong conflict between the Navy pursuing its Defense mission (building weapons) and fighting waste, fraud and abuse."

The most severe action the Navy can take is to debar or suspend the contractor. This would entail pulling existing contracts away from the contractor and forgoing future contracts, either on a permanent or temporary basis. Debarment requires a full administrative hearing, where the Navy must establish sufficient evidence of wrongdoing.[**] According to the Navy lawyer, the enormous amount of time and effort needed to pursue the evidence dissuades the Navy from utilizing these remedies. This is particularly true when a firm has not been previously indicted. An indictment is usually all the evidence the Navy needs, the lawyer told us. Without it, the Navy will stand back.

However, reliance on indictments pose several problems. First, the Department of Justice and the U. S. attorneys have been reluctant to pursue criminal prosecution for mischarging. Mischarging cases, utilizing auditors and investigators, require more time and effort than most U.S. attorneys want to devote to a case.[***]

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[*] Telephone interview with Ms. Margaret Olson, Asst. General Counsel for Acquisition.

[**] However, a suspension does not require a full hearing when there is probable cause of wrongdoing. (DAR 1-605)

[***] In October of 1982 the Military Fraud Procurement Unit was created within the Department of Justice. The Unit's chief states that mischarging cases will be high on their list of priorities.

Secondly, even where indictments are issued, the Navy is reluctant to act. Before a decision is made to proceed with debarment or suspension, the Navy must take into account its relationship with the contractor, the Navy lawyer told us. The Department will look at how essential the contractor is to "carrying out our mission." In many cases, debarment or suspension actions are not pursued because the Navy must continue to do business with the company. This is particularly true with the large contractors, such as Ingalls. This conflict may explain why the Navy took no action against Litton after it was indicted for fraudulent claims in 1977. After the indictment, NAVSEA made no recommendations and the Navy's legal counsel took no action.

It should be noted that there are other remedies, less severe, than suspension or debarment available to the Navy which remain virtually unused. These include:

—Withholding payment. If the government owes the mischarging contractor money, the government could withhold it. If the government has already paid, it could withhold payment for the remainder of the project.

—Default on performance. The government can consider the mischarging a default on performance and sue for damages for default.

—Use of DAR 1.904. This regulation states that before the contracting officer can award the contract, he must make an affirmative determination that the contractor is responsible. Evidence of mischarging would clearly indicate the contractor was not responsible. The Navy lawyer told us the Department won't utilize this remedy because of the evidentiary problems it poses. Before a contractor is not awarded a contract on the basis of 904, he must be given an opportunity to contest the finding of "not responsible" and present whatever evidence he can to refute the claim.

—The Contracts Dispute Act. The fraudulent claims section of the act allows the government to collect double damages for misrepresented or fraudulent claims.

These remedies have not been effectively used by the Navy. With respect to DAR 1.904, at the very least the Navy should acknowledge the contractors are irresponsible and then make the determination that the Navy still needs the new weapons or boats.

Still less severe remedies, suggested by the Navy's own legal counsel, include:

—More vigilance on management decisions

—More insight into cost pricing by Navy officials

—More aggressive contract administration

—More detailed cost analysis

One instrument available to DoD for pursuing some of these remedies has been almost completely ignored. The Defense Department has been slow to implement the Truth in Negotiations Act. Last month, the Senate Committee on Governmental Affairs held hearings on the Act, which allows the government to audit the records of sole-source contractors to find out whether they had, but failed to submit, better and more accurate cost and pricing data. Under the law, procurement officials can reduce the contract price or recover contractual overpayments if a post-award audit discloses defective prices.

The Senate Committee severely criticized DoD's implementation of the law. Senator William Roth of Delaware, for example, said poor contract audit work provided inadequate support for defective pricing findings; government procurement officials have weakened its effectiveness by not promptly acting on and sustaining valid defective pricing audit findings.

* * * * *

The current Administration has announced an ambitious shipbuilding program to remedy the erosion of U.S. naval power; the proposed five year program is estimated to cost over $80 billion. Whether that vast sum is spent efficiently or effectively depends in large measure on the federal government's oversight of Navy spending.

That oversight is not being performed effectively should be apparent from this report. This finding is not unique to the BGA; others; especially the General Accounting Office, have produced findings that is many ways parallel our own.

One explanation for the failure to bring waste, fraud and abuse under better control has been offered by Admiral Hyman Rickover (retired):

> The situation in which we find ourselves with Litton is endemic in Navy shipbuilding contracts. We have permitted ourselves to become enmeshed in a situation which has subtly and gradually eroded the proper, legal, and customary relationship with shipbuilders; we have become their custodian and have assumed responsibility for their welfare. In essence we have no real contracts — no true meeting of minds.
>
> . . .
>
> If the Navy permits this relationship to continue, we will not be able to buy the ships we need, no matter what sums Congress appropriates. We must become alive to the fact that Congress and the public are rapidly losing confidence in the Navy because of our way of doing business, and this bodes ill for our future.

If Admiral Rickover's assessment is correct there is little chance that the Navy's oversight over Ingalls (Litton) or any of the other shipbuilders will improve until the "proper legal and customary" relationship with them has been restored. Millions of tax dollars are at stake — and also at stake is the integrity of the governmental process.

DEFENSE CONTRACT AUDIT AGENCY
ATLANTA REGION
INGALLS SHIPBUILDING DIVISION
LITTON SYSTEMS, INC.
PASCAGOULA, MISSISSIPPI 39567

IN REPLY REFER TO

1.421/1382 11 November 1982

SUBJECT: Audit Report on Floorcheck of Material Support -
Cost Center 319
Ingalls Shipbuilding Division, Litton Systems, Inc.
Pascagoula, Mississippi
Audit Report No. 1421-2C130119-10

TO: Supervisor of Shipbuilding, Conversion and Repair
U. S. Navy
ATTENTION: Code 400
Pascagoula, Mississippi 39567

1. Purpose and Scope of Audit:

As part of our overall audit of Ingalls' timekeeping and attendance practices, we made a floorcheck of selected Material Support employees - Cost Center 319. The main objective of the floorcheck was to test the accuracy of timekeeping practices.

The floorcheck was performed in accordance with generally accepted auditing standards and included such tests of the contractor's data and records and other such auditing procedures we considered necessary in the circumstances.

We performed a floorcheck of 43 selected employees. We determined if the selected employees were on the job, performing in their assigned job classification, and if their time was properly recorded. During physical observations of selected employees, the appropriate labor time charge numbers were verified to supporting documentation. In addition to the sample, we expanded the floorcheck to include all the Material Support employees in the combined shops and in the trailer area. We performed the floorcheck in June 1982.

2. Summary Results:

Results of our floorcheck were as follows:

	Number Selected	Number Floorchecked	Charging Wrong Contract	Percent Errors
Cost Center 319 Sample	43	40	3	7%
Combined Shop Group	12	12	7	58%
Trailer Group	17	17	2	12%

Our review disclosed two conditions which require corrective action. These conditions are summarized below and discussed in detail in Appendices 1 and 2 of this report.

The Material Support group in the Combined Shops is using a pre-planned charging schedule resulting in a 58% error rate. (Appendix 1)

Direct exempt employees are not completing the Time and Labor Charging Record as required by Standard Procedure 3090.11. (Appendix 2)

3. Concluding Remarks:

We held an exit conference on 3 August 1982 to discuss findings and conclusions from the audit and to request the contractor's response. The following Ingalls' personnel attended the exit conference;

T. A. Santobianco, Director of Materiel Operations & Control
R. J. Brandenburg, Group Manager of Inventory Management & Operations Support
R. A. Siedell, Materiel Administration Representative
J. W. Cox, Audit Liaison

The contractor's response was received 7 September 1982 and their comments have been incorporated into Appendix 1 of this report.

This office will give any further accounting advice or audit assistance that may be needed.

Defense Contract Audit Agency

Vernon B. Tabor
VERNON B. TABOR
Resident Auditor

Copies furnished:
SUPSHIP/Code 160

Audit Report No. 1421-2C130119-10

Ingalls Shipbuilding Division, Litton Systems, Inc.
Pascagoula, Mississippi

STATEMENT OF CONDITION AND RECOMMENDATION

Use of Pre-planned Charging Schedules:

1. Condition:

Our sample included five employees in the Material Support group located in the Combined Shops. We found two of the five charging incorrectly. The floorcheck was expanded to include the remaining seven employees in this section. Five of the seven were charging incorrectly. There were a total of seven errors for the twelve floorchecked resulting in an error rate of 58%. The seven were charging to the wrong contracts due to the use of pre-planned charging schedules.

The practice of charging employees' time direct to contracts according to pre-planned schedules is an invalid and unacceptable timekeeping practice and should be discontinued immediately. The use of such a practice indicates that perhaps the group should be charging their time indirect rather than direct. In our opinion, the use of such a timekeeping practice completely destroys the creditability of any cost data applicable to the organization using it.

2. Recommendation: We recommend that the practice of using pre-planned schedules for timekeeping be discontinued immediately. If an employee cannot specifically, economically and consistently identify his time to a specific cost objective at the time the work is being performed, then that employee should be classified as indirect rather than direct.

3. Contractor's Reaction:

The contractor has, through staff meetings, instructed all employees to charge to the actual contract on which they worked and that the use of pre-planned charging schedule shall be discontinued.

Audit Report No. 1421-2C130119-10

Ingalls Shipbuilding Division, Litton Systems, Inc.
Pascagoula, Mississippi

STATEMENT OF CONDITION AND RECOMMENDATION

Failure to Complete Time and Labor Charging Record:

1. Condition: Our floorcheck disclosed that all West Bank employees are using a Monthly Time Book instead of the Labor Charging Record required by Standard Procedure 3090.11. The Monthly Time Book is kept by the employee but is not signed. Most of the East Bank employees use the Time and Labor Charging Record. However, we found that the group in Warehouse 11 does not prepare their charging records. They are prepared by supervision. At the time of our floorcheck 21-24 June 1982, their Time and Labor Charging Records for the week ending 20 June 1982, had not been prepared.

2. Recommendation: We recommend that all direct exempt employees be required to keep Time and Labor Charging Records in accordance with Standard Procedure 3090.11. This should improve the integrity of labor charges.

3. Contractor's Reaction:

> Employees have been instructed to record their time charges on a daily basis and to sign the record each day. This is in accordance with Standard Procedure 3090.11.

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JEANNE MARIENTHAL WEISLOW
JOHN J. WHITE
Midland Manufacturing Corporation

May 6, 1983

The Honorable William V. Roth, Jr.
Chairman
Committee on Governmental Affairs
Permanent Subcommittee on Investigations
SR-100 Russell Senate Office Building
Washington, DC 20510

Dear Chairman Roth:

The purpose of this letter is to clarify a matter that arose during your May 3rd hearing into mischarging on Navy shipbuilding contracts. It was said at the hearing that a statement appearing on page three of our written testimony did not accurately reflect a November, 1982 DCAA audit finding. The BGA stated that "various audit reports, for example, have found up to fifty-eight percent (58%) of Ingalls' labor charges were incorrectly billed to the government when small samples were involved." We believe this statement is correct. Indeed, even higher mischarging rates have been found in some units at Ingalls' shipyard.

Apparently one member of the Committee believed the BGA was saying that the 58% figure included only cases in which labor was mischarged from private oil rig contracts to the government.

Incorrect billings to the government (mischarging) may encompass situations in which labor is improperly billed from: 1) private to government contracts; 2) between government contracts; and 3) from government to private contracts. In all these cases the government is incorrectly billed. In the third example the cost to the government is artificially deflated but, as Senator Cohen noted during the hearing, this is also a form of abuse. Any incorrect billing distorts the data base upon which the government estimates cost. The contractor can take advantage of this form of mischarging because its performance record will appear better than it really is. Consequently, the contractor may be awarded future contracts based on false cost performance.

J. TERRENCE BRUNNER
executive director
TERRANCE A. NORTON
assistant director

PHYLLIS C. KINZER
membership coordinator
JOHN B. LAING
research coordinator

PETER M. MANIKAS
legislative counsel &
chief, D.C. office

E. STANLEY ENLUND
Chairman
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President

*Contributions Are Deductible By Treasury Ruling

Even if the latter category of mischarging (from government to private contracts) was not considered to be charges "incorrectly billed to the government," the BGA's statement would still stand incontroverted by DCAA's subsequent "reexamination."

A DCAA letter of March 14th, as was pointed out in the hearing, indicates that two of the twelve workers whose time was mischarged had their time charged from government to commercial contracts. However, there is no indication that these two workers were in the unit to which the 58% figure refers.

As the November 11th audit indicates, three units were examined by DCAA; error rates of 7% were found in the Cost Center 319 sample, 58% in the Combined Shop Group and 12% in the Trailer Group. There is no indication in DCAA's March 14th letter that the two workers whose time was mischarged to commercial contracts were located in the Combined Shop Group. A copy of the information we received from DCAA accompanies this letter.

In any case, other instances of mischarging have been found to exceed 58%. In a recent civil action alleging that Litton Systems, Inc. (Ingalls' parent company) had improperly billed the government for work performed on oil rig contracts, it was found that 62% of the man hours involved in the suit had been erroneously charged to Navy contracts.

We do not, of course, contend that such high mischarging rates could be sustained across a broader sample. Our testimony also makes that clear. We do believe, however, that when very high mischarging rates are found in small samples of workers, that finding should trigger a more thorough scrutiny of the contractor's time-keeping practices.

To summarize, we believe that our use of the 58% figure is correct and an even higher figure could be used.

I hope this letter clarifies the issue raised at the hearing. The BGA appreciates the Committee's invitation to testify and to contribute to your much needed examination of mischarging on Navy shipbuilding contracts.

Sincerely,

Peter M. Manikas

Peter M. Manikas
Legislative Counsel, BGA

Enclosure

DEFENSE CONTRACT AUDIT AGENCY
ATLANTA REGION
INGALLS SHIPBUILDING DIVISION
LITTON SYSTEMS, INC.
PASCAGOULA, MISSISSIPPI [illegible]

IN REPLY REFER TO
1.421

14 March 1983

MEMORANDUM FOR THE SUPERVISOR OF SHIPBUILDING, CONVERSION AND REPAIR, U.S. NAVY, PASCAGOULA, MS 39567

ATTENTION: Code 132

SUBJECT: Freedom of Information Act Request - Follow up of "Floorcheck of Material Support Cost Center 319"

Your letter of 4 March 1983 requested copies of any documents discussing or describing a follow-up of the subject audit. Please be advised that, as of this date, no follow-up of the subject review has been performed. The most serious of the two reported conditions, pre-planned time charges, was corrected during the course of our review and no immediate follow-up action in this cost center is considered necessary. The other condition, failure to complete time and labor charge records, is one that potentially affects all organizations with salaried exempt employees. A review addressing this matter is currently in process for the contractor's Operations and Engineering directorate employees. A comparable review of the Materiel directorate of which the Material Support cost center is a part is scheduled for the near future.

Since the report covering our labor floorcheck of the Material Support cost center reflects an unusually high labor rate and is the subject of a Freedom of Information Act request, we believe that some amplification is required to preclude the contents of the report, if released, from being misunderstood, misused or construed as representative in any way of the contractor's overall timekeeping system. It should be considered that:

(i) The timekeeping errors observed in this review are atypical in that they are the only instances of labor mischarging between Government and commercial contracts disclosed in our floorchecks over the past two and one-half years.

(ii) Only 3 of the reported contract level errors involved mischarges between Government and commercial contracts. The remainder of the errors represented mischarges between Government contracts of the same type (cost reimbursable).

(iii) Two of the three errors discussed above involved employees actually working on Government cost-type contracts but charging their time to firm-fixed-price commercial contracts.

Although not specifically addressed in your 4 March letter, the matter of cost adjustments resulting from time-charging errors emerged in subsequent discussions between our offices. In most instances, such adjustments would be difficult, if not impossible, to calculate and the accuracy would be suspect at best because:

(i) Our observation of a given employee represents only a fraction of his or her total workday. Therefore, there is no way short of continuous observation to factually establish the number of hours actually involved in the mischarge.

(ii) Normally, 3-5 days elapse between the time of our interview and the time we establish that there has been a mischarge. This is the time required for timecards to be collected, processed and filed in the Payroll Department. Consequently, any attempt to quantify the error would be totally dependent on the memory of the employee involved.

Cost adjustments for timecharging errors of the nature disclosed in our floorcheck of Cost Center 319 would normally be limited to extraordinary circumstances where there is evidence that significant amounts of mischarged costs are involved. Our primary concern for the findings cited in the floorcheck of Cost Center 319, as with any other labor floorcheck, is one of getting prospective resolution of any timekeeping deficiencies cited. As stated in the first paragraph above, we believe that the contractor responded positively to the principal audit findings and recommendations and we plan to continue our systematic labor floorchecks to assure continued compliance with the audit recommendations.

If you have any questions or require additional information, please contact Ron Johnson or me at 935-3814.

FOR THE REGIONAL DIRECTOR:

Vernon B. Tabor
VERNON B. TABOR
Resident Auditor

PREPARED STATEMENT OF LEONARD ERB

Mr. Chairman, Members of the Committee.

My name is Len Erb. I have been an employee of Litton Industries for 19 years and I am currently a senior vice president of Litton Industries and responsible for Litton's Marine Group activities. In that capacity, I also serve as president of Litton's Ingalls Shipbuilding Division, a position I have held since 1975. I am assigned full-time at Ingalls Shipbuilding located in Pascagoula, MS and I am thoroughly familiar with both the policies of the company and the procedures under which we operate our shipyard. I have with me today, Jerry St. Pe', Vice President of Public and Industrial Relations, whose responsibility includes matters associated with our internal investigation programs, and Ed Robbins, Vice President of Administration, whose responsibility includes contracts administration, financial accounting, and internal audits. Mr. St. Pe' has been an employee of Ingalls Shipbuilding for about 18 years and Mr. Robbins has been with our company for 16 years.

In your letter of April 21, 1983 in which you invited us to appear before the Committee, you asked that we address several specific topics. Before I address those topics, I wish to make a few general comments for the record.

Ingalls Shipbuilding has been building Navy ships in Pascagoula, Mississippi since 1938. The company's east bank facility produced troop ships in World War II, as well as escort aircraft carriers, submarine tenders and net layers. After the war, Ingalls produced amphibious assault ships, Forrest Sherman class destroyers, and beginning in the late 1950's, nuclear powered attack submarines. In the past 15 years, Litton has invested more than $350-million in building and modernizing its shipbuilding facilities in Pascagoula.

In the late 1960's, Litton Industries and the State of Mississippi, at the urging of the Navy, joined together to build an entirely new, modern shipyard -- the only new shipyard that has been built in this Country since World War II.

The shipyard was built on a new concept, which Ingalls pioneered in the 1970's -- that of modular construction. This system has since been applied to the construction of Spruance class destroyers, LHA amphibious assault ships, KIDD class guided missile destroyers and is currently being applied to the construction of the Ticonderoga Class Aegis guided missile cruisers.

CHART 1 This technology has proven itself, and has provided the Navy with the world's most capable facility for the construction of destroyers, cruisers and amphibious ships.

CHART 2 Since mid-1975, Ingalls Shipbuilding has delivered 41 sophisticated new warships to the Navy, and they are operating in the Fleet around the world. The 30 ships of the original Spruance class destroyer contract and five LHA amphibious assault ships were all delivered within a five-year period between 1975 and 1980, establishing peace-time production records. In 1981 and 1982, the four Kidd class guided missile destroyers were delivered to the Navy by Ingalls on schedule and under budget. And thus far in 1983, Ingalls has delivered the 31st Spruance class destroyer, USS Hayler (DD 997) and USS Ticonderoga (CG 47) the first Aegis cruiser.

Other important work at Ingalls has included the regular overhaul of the Navy's Spruance class destroyer fleet. No other shipyard in the Country has matched the record of Ingalls' quality and schedule in overhauling Spruance class destroyers. Since 1981, we have completed overhauls on three ships, all re-delivered ahead of schedule despite significant growth in the quantity of work items accomplished on each ship.

The performance of Ingalls, and our reputation with the Navy for quality work produced within budget and on, or ahead of, schedule was one of the primary reasons Ingalls was competitively selected by the Navy in mid-1982 to modernize and reactivate the battleship Iowa. This ship, which has been under our jurisdiction since October, will be reactivated in

June 1984, under a revised schedule which is six months earlier than originally planned by the Navy.

We were asked to summarize the company's performance in constructing Ticonderoga. Perhaps the greatest benefit to the Navy and the nation is occurring at Ingalls in the CG 47 Aegis class cruiser program. As the first ship built specifically to protect our aircraft carrier battle forces from the threat of attacking missiles, these ships are among the most important elements of a new 600-ship Navy. They are the most capable ships in the world as it pertains to anti-submarine and anti-air warfare, and probably a decade ahead in AAW.

In September 1978, following competitive bidding, Ingalls was selected as lead shipbuilder for the CG-47 program. In addition to USS Ticonderoga, Ingalls has been awarded construction contracts for five other cruisers, and is procuring long-lead material in preparation for the construction of three more ships which were funded by Congress in FY 83. We are also under a contract to assist in bringing another shipyard on line for production of these important ships.

Ticonderoga, despite being the first of a new class, and incorporating a totally new weapon system technology, and despite more than 2,000 changes incorporated into the ship, was delivered to the Navy this past December six weeks ahead of the schedule which was established four years ago at original contract award. And she was delivered not only within budget, but at a lower cost than the first of the Spruance destroyers, its root ship and a far simpler and less capable ship.

The commissioning of Ticonderoga in January of this year, ahead of schedule, was not the first major success story in the construction of the Aegis cruisers. In August of last year, that ship became the first in recent naval history to successfully test fire all major weapons prior to commissioning. Normally, extensive test firing occurs after the ship joins the Navy Fleet. During those trials, 11 test missiles were fired from the ship's missile launchers. Two Harpoon test missiles and Phalanx and deck gun ammunition were also successfully fired. The high point of the sea trial, though, was the successful tracking and intercept of a drone target simulating an attack. We fired two live missiles at separate targets -- and both scored hits. The success of those trials can be attributed not just to the performance of Ingalls, but to the working relationship between the Navy, both civilian and military, and its contractors. Because of this and our accommodation of new technology when it was available, the ship will be battle ready for deployment at least six months earlier than 963 and five months earlier than 993. Early availability of a $1-Billion investment is significant.

We have done well in building and delivering Ticonderoga. But Ingalls is a company that is not satisfied with yesterday's performance. Our management and our employees understand and support the need for a strong Navy. We understand the need not only to build ships well, but to build them efficiently. We are conscious of the need to continually improve our performance -- for the benefit of the Navy and the Nation.

While we performed well in building Ticonderoga, we are performing even better in building the second ship of the class, Yorktown (CG 48), which was launched at the shipyard in January, and christened in ceremonies April 16.

Here are a few examples of our improved performance:

When we launched Ticonderoga in April 1981, she was 52 percent complete. We launched Yorktown in January of this year -- at 59 percent complete, a 15 percent improvement rate. Today, Yorktown is 70 percent complete. The period of time from cutting the first plate of steel until launch was also drastically reduced in the construction of CG 48 from 92 weeks to 80 weeks.

And the list goes on. Major equipment items -- main engines, reduction gears, electrical generators and power distribution systems -- were all installed aboard Yorktown earlier in the construction process than aboard Ticonderoga. And we will begin the crucial testing of Yorktown's Aegis weapons system 12 weeks earlier than we did aboard Ticonderoga.

Perhaps the most significant measurement in the construction of a warship is the number of manhours expended for each percent of construction progress. That figure has also been significantly reduced in building Yorktown.

These accomplishments were possible because the Navy and Ingalls are devoting their full efforts to building a better ship instead of preparing for court battles. Selection of an appropriate form of contract contributed significantly to this achievement.

We are asked to address the subject of Ingalls experience with Navy procurement practices. As you are aware, Navy shipbuilding during the early and mid-1970s saw the government and its major shipbuilders engaged in the processing of claims and in expensive and distracting litigation in connection with those claims.

Both the LHA contract dated May 1, 1969, and the DD 963 contract dated June 23, 1970, were Total Package Procurements requiring the design, development and production of the ships to be awarded on a multi-year basis. The contracts were fixed price incentive successive targets with escalation.

The total package procurement concept implemented with a fixed price incentive type contract was an absolute failure for many reasons. Among the most important reasons was that it didn't provide for proper sharing of the risks involved in the design and construction of a new class of warship. It also required the Navy to operate in a totally unfamiliar "hands off" mode in its management relationship to the contractor. Even if the Navy could have accommodated to that mode of operation, it is not appropriate for complex warship construction because it can result in a nearly outmoded ship at time of delivery. Court battles resulted and claims preparation costs in the millions, and distraction of senior management followed. Total package procurement was discarded.

On June 20, 1978, Ingalls settled its claim under the LHA/DD 963 contracts with the U.S. Navy and in October 1978 it was ratified by the U.S. Congress. This settlement cleared the air and allowed a resumption of normal business relations between the Navy and Ingalls which have continued to this date.

The Navy not only discarded the Total Package Procurement concept, but in the mid seventies changed from a fixed price incentive type contract to a cost reimbursement type contract for the first ship of a class. As a consequence, Ingalls was awarded the 4-ship DDG 993 contract, on a cost plus incentive fee basis.

The cost plus incentive fee contract does provide for proper risk sharing and gives the Navy the flexibility to make the changes needed to assure an effective warship at delivery. The incentive feature rewards the contractor for good cost performance and, in fact, on the 4-ship DDG 993 program, Ingalls underran target cost by tens of millions of dollars.

The Navy desired to not only incentivize cost but also its evaluation of quality, technical and management performances. Therefore, in 1978 the Aegis Cruiser contract, which Ingalls won in competitive bidding, was awarded under a cost plus award fee contract. This is the best contractual vehicle currently in use for complex warship design and construction produced the results I have already described for Ticonderoga.

There are pressures, including pressure from Congress, to move away from Cost Plus Award Fee back toward Fixed Price. Some of that is appropriate where there is stability in the design. But complex ships in the Navy's shipbuilding program probably never will have sufficient stability of design to realistically qualify for Fixed Price contracting.

I fear movement toward fixed price is too rapid. It has never been proven to me that fixed price will always, or even most of the time, produce the lowest cost product. It is a "cop-out" for inadequate management skill.

My recommendation is to carefully examine the risks and the needs of the particular program in selecting the contract type and don't fall victim to the "fixed price is a virtue to itself" syndrome.

You have requested that we speak to the subject of our company's policies and practices to assure the accuracy of cost data on contracts.

Ingalls Shipbuilding Division's time charging policy is now, and always has been, that all employees charge their time to the job on which they work, absolute and without deviation.

Accurate and timely labor time charging is vital to the very existence of any company, including Ingalls. Actual labor costs recorded through time charging are used to bill Ingalls' customers for work performed, to manage the work being performed and to provide historical costs which serve as a basis for our estimates for new business. In other words, accurate and timely labor time charging is essential from a customer's point of view so that he knows he receives value for which he pays and from management's point of view so that present work can be managed and new work can be obtained. Without accurate and timely labor costs, a company would, in due time, cease to exist.

We have four (4) Policies, five (5) Standard Procedures and fifteen (15) Departmental Operating Instructions which set forth in detail the way in which time is to be charged and the penalty for falsifying time charges. Copies of the Policies and Procedures have been made available to the committee.

Accurate time charging is difficult to achieve. The more varied and complex the engineering and manufacturing process, as in shipbuilding, the more difficult it is to control. The added factor of a large number of employees increases this difficulty.

Ingalls has for many years recognized the importance and the difficulty of accurate and timely labor time charging. In 1975, when Ingalls employment exceeded 20,000 employees and shortly after I assumed the Presidency of Ingalls, we began an "all out" effort to re-emphasize the importance of accurate time charging.

The following are representative of the actions taken:

1. Company Policies and Standard Procedures are distributed throughout the Company.

2. New employees receive a copy of the Company's Manual of Rules and Regulations and, if applicable, the union contract. Both clearly define the penalty for falsification of time cards.

3. Company bulletins on time charging are issued periodically and placed on bulletin boards throughout the company.

4. An employee promoted into a supervisory position must attend a 24-hour Principles of Management and Company Functions course in our Training Department. This includes one hour of instruction in timekeeping and time card preparation.

5. Articles in our company newsletter emphasize the need for accurate time charging.

6. Ingalls Internal Audit conducts unannounced time charging audits. Operational audits include the review and testing of timekeeping practices to verify compliance with company policies and procedures. Since 1981, Ingalls Internal Audit and DCAA have conducted a total

of 46 timekeeping audits. Each of these is analyzed and corrective action is taken.

7. As a further refinement and improvement in timekeeping, we issued a new Standard Procedure, "Time and Labor Charging Record (Direct Exempt Employees)" dated 5/27/82. This procedure requires that each direct exempt employee, such as an engineer, maintain a personal diary of hours worked against each job for each day. It requires that he sign this record which is to be maintained for a period of six months. This data from the diary is to be transferred to his time card which is then signed and forwarded to his supervisor for approval.

Ingalls' policy with regard to time charging is clear. Employees' time is to be charged only to the contract on which that time has been spent. That's the written policy. And it's the policy to be followed and the one we enforce.

And as a management, we have been aggressive in enforcing the policy. We conduct periodic audits to verify that the policy is being followed and when it is not, we take corrective action. And we administer discipline to those in our workforce who, for whatever reason, violate the policy.

During the past five years, 165 employees (including some in supervision) received some form of discipline for time charging violations. Of that number, 66 were discharged because of the nature and circumstances of the violation.

In operations the size of Ingalls Shipbuilding, in which more than 20-million manhours are performed each year by 10,000 employees, assuring accurate time charging gets a lot of attention. In addition to Ingalls' internal programs of audit and DCAA checks, we have on site many military and civilian personnel, of which many are dedicated to monitoring and surveying the quality, cost and schedule performance of our contracts. Additional government personnel with responsibility for reviewing us are based in Washington. But, despite this effort, some level of misassignment occurs. We don't condone or tolerate any level of improper charging of time, but one must strike a balance between absolute control and return for the investment made in monitoring and surveillance.

What we are acknowledging here today concerning the misassignment of manhours has already been properly reported to the appropriate government agencies, the Navy, the Defense Contract Audit Agency, the FBI and this Committee. And the record should properly reflect that it was Ingalls internal investigation and audits, not those of outside agencies, that quantified the degree to which misassignment occurred. While other reviews of this matter have been undertaken by other agencies and organizations, we have been provided no information -- none at all -- which conflicts with the results of our company's review and findings.

You are aware that 60-Minutes and the Senate's investigators have been testing our time charging system.

CHART 3 In support of that examination, we have conducted investigations and audits and we have verified and quantified a total of about 18,000 hours misassigned from a workforce that has averaged nearly 18,000 employees over the past six years.

CHART 4 The 18,000 manhours that were misassigned are from among more than 93-million manhours worked and charged directly to contracts at Ingalls during the period over which the misassignment occurred. Said another way, the misassigned hours represent the total time of about two (2) employees out of 10,000 for that period.

CHART 5 And although the error rate is very low, the misassignment occurred in violation of our company policies. It was caused by a very few lower level management personnel and some individual workers. I will examine the motives a little later.

I should like to separate the misassigned hours into two separate groupings -- commercial work misassigned to Navy contracts, and Navy contract to Navy contract misassigned. During the period from April 1979 to April 1982, an estimated 3,081 manhours were improperly assigned to Navy contracts.

CHART 6 Some have inferred that this significantly improved our position on the unprofitable drill rig programs that were underway in our shipyard at the time. Examination of the dollar amounts involved shows that could hardly be the case -- not on a program with a $411-million cost being relieved by $66,000 of misassigned time (the value of 3,081 misassigned hours).

CHART 7 Certainly no management would risk "fraud" charges for those returns. And, indeed, Ingalls did not. And even if one confines the comparison of misassigned hours only to engineering costs, it is obvious that engineering had no planned program of "fraud."

As part of Ingalls' internal investigation, we found that during the period of about September 1978 until August 1981, between 10,000 and 15,000 engineering manhours may have been misassigned between various Navy contracts -- meaning that work was performed on one Navy program but the time involved was actually charged to another. It involved work done on the CG 47 cruiser and misassigned to the DDG 993 and DD 997 programs. The 10,000 to 15,000 hours were among more than 6-million engineering hours worked by Ingalls during the period. While the misassignment was wrong and in violation of policy, it is important to understand that such misassignment does not mean that the government paid for something it did not receive. To the contrary, the government did receive appropriate service -- but the proper government contract was not charged for the work. Ingalls in no way benefitted, financially or in terms of cost performance, by this misassignment.

Ingalls could have benefitted only if it made a contract, whose profit depended heavily upon subjective evaluation of cost performance, appear much better that in fact it was.

CHARTS 8, 9, 10, 11

The following series of charts clearly demonstrate such was not the case.

While misassignment did occur, it did not occur for the reasons that have been alleged, nor with the consequence to government contracts that have been suggested. The facts are clear on this. Why then did it occur? What was the objective of those few employees who were involved? There was no personal gain for the employees - none was possible. After more than 3,800 manhours of internal review, audit and investigation, we have concluded that a combination of management pressure and individual convenience were the major influences.

CHART 12 Filling out a timecard can be very inconvenient and complex for one whose day is spent working on several different contracts. Examination of an actual time card reveals that. Therefore, there is a temptation to simplify. It can also appear frustrating to an individual to get additional budget for an emergent task, so one might be tempted to temporarily "borrow" from existing already approved budget in anticipation of budget for the new task. That is what I mean by convenience.

What about management pressure? I have said earlier our company strives for constantly improving performance. I do not apologize for making people budget conscious at Ingalls Shipbuilding. I only regret that a few, a very few, succumbed to that pressure by taking improper actions.

Have we found all of the misassigning? We believe we have. I can assure you that we have aggressively investigated and audited and followed through on every single piece of information we ourselves have developed or had provided to us.

CHART 13 What if by chance we have not found all of the misassignment of hours? Even if the 18,000 hours doubled or even tripled, the conclusions would not be different. It would not indicate planned "fraud" by management nor an out of control condition, nor a significant financial benefit to Ingalls Shipbuilding.

If one examines the time and effort expended by various activities during the intensive review of this matter over the past six months, I suspect the costs involved certainly approach the value of the costs of the misassigned hours. Ingalls' costs alone equaled that of the hours which were misassigned between commercial and Navy contracts.

We have been asked to address our company's policies with regard to "whistle-blowing." If you are asking us if we take action on information concerning possible wrong doing that needs correcting, the answer is yes. Do we encourage people to come forward with such information? The answer is yes. Do we punish employees for going to legitimate government agencies with information about our company? The answer is no -- and we never have. Do we punish them for going to the legitimate press? The answer to that is no. Do we punish them for going to those who deal in sensationalism for commercial gain and entertainment, or those who are self-appointed pseudo-investigative bodies that are neither legitimate media or government and who are answerable to no one for their conduct? The answer to that is no -- but we don't encourage that kind of conduct.

At Ingalls, it is the practice of management to create an environment that encourages employees to speak up about activities that are wrong, and need correcting. And such an environment does exist. And it is achieving results.

We have an extensive internal investigation and auditing program at Ingalls. At any one time, we have a number of investigative cases being carried on.

Approximately 90% of all investigations at Ingalls are initiated or aided by information supplied by concerned employees. Employees call, send letters, and supply information by other means. Sometimes this information comes to us anonymously. In all cases, the identity of the persons providing information is kept strictly confidential, and I know of no instance in which an employee has suffered adverse consequence as a result of having come forward with information.

I could present to you a number of factual examples in which information, voluntarily furnished by Ingalls employees, has resulted in company investigations and audits which have revealed activities that needed correcting. One such case is still current, and I wish to share with you some of the details. An employee contacted the head of our investigation staff and provided some information which indicated some irregularities in the handling of petty cash invoices in one area of our shipyard operation. Following an eight-month investigation, which involved the methodic review of thousands of petty cash invoices, five Ingalls employees, including a member of management, were discharged in connection with the submittal of more than $130,000 in bogus petty cash vouchers. Our investigation shows, using unauthorized invoices from a number of companies, these employees were forging the names of their supervisors on company vouchers and were being "reimbursed" for material which they claimed they purchased for the company, but in fact did not. The five employees were discharged. And the appropriate Navy contracts were adjusted. Since government funds for Navy programs were involved in this case as well as funds for commercial programs, the results of our company investigation have been shared with the FBI. Two weeks ago a Jackson County, Mississippi grand jury indicted two of these former employees on charges of false pretenses. An investigation by the FBI is continuing.

I think it is important to make one additional point in connection with the case I just described to you. Two of the former Ingalls employees, who were discharged for their participation in the petty cash scheme, have made serious, false allegations about our company in interviews with the CBS show, 60-Minutes. They have also been interviewed by the investigators from this Committee.

Those interviews took place months after their discharge from Ingalls. The allegations they have made were never brought to management's attention prior to their discharge. But, more important to the point of these hearings, the allegations they have made have been proven to be incorrect. A full investigation and audit by Ingalls have shown the allegations to be without foundation, and information associated with this audit have been made available to the FBI and this Committee.

Ingalls' internal investigations and audits, many of which are conducted in conjunction with the FBI and the Naval Investigation Service, have resulted in the recovery of hundreds of thousands of dollars in government funds and property. But, equally important, these investigations reflect our company's aggressiveness to protect that which has been entrusted to our care.

In our investigations and audits, we seek not merely to discover or uncover. When we find wrongdoing, we stop it. We make every effort to recover funds and property which may have been misappropriated. We take appropriate internal disciplinary action and where warranted, cooperate with the proper authorities in prosecution of individuals who have broken the law as well as violated our policies. And, finally, as part of our investigative and audit process, we review our systems and controls to determine what we can do additionally to make them less vulnerable to violation.

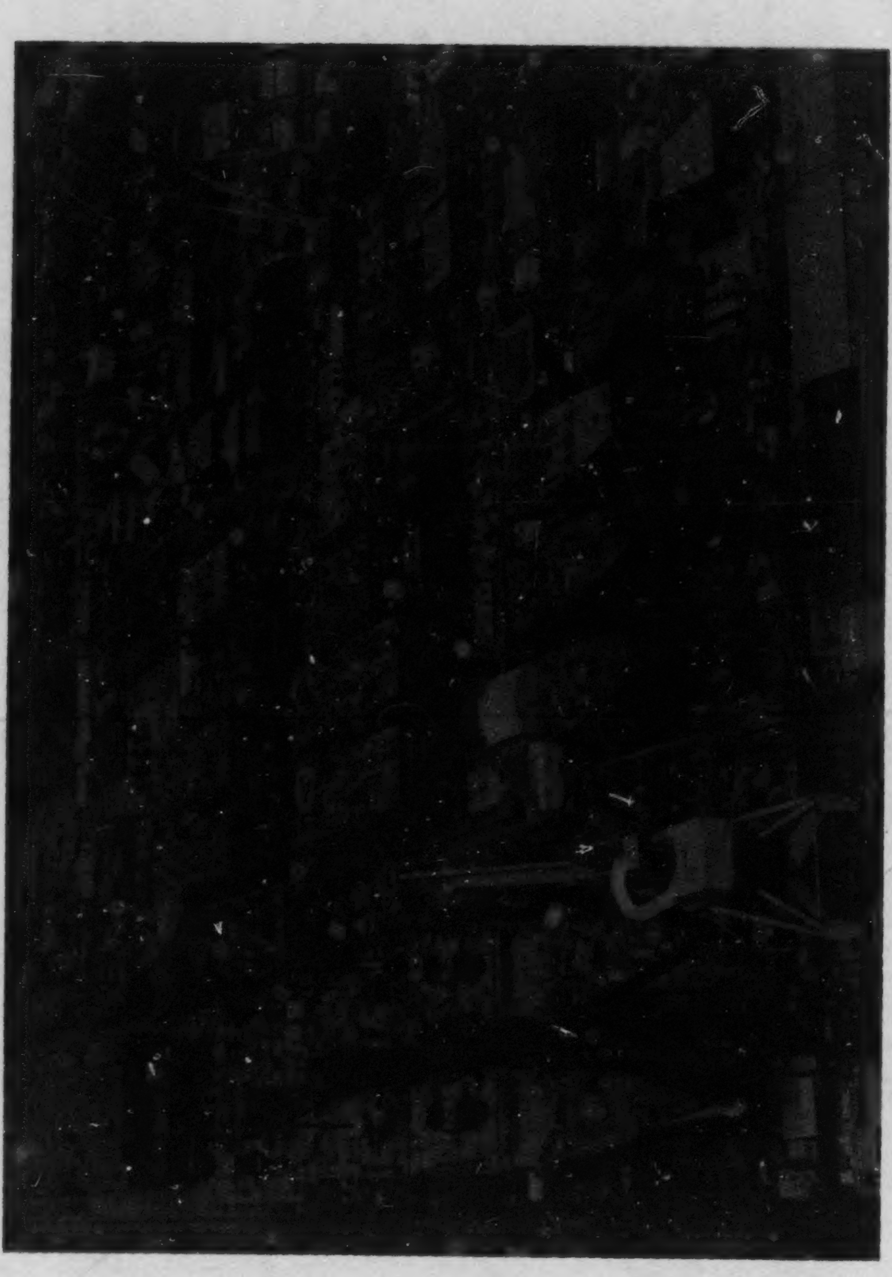
At Ingalls Shipbuilding, the quickest way to get corrective action is to come to us -- the management.

We have given this Committee and its staff our full cooperation. Since November, when we learned of the Committee's interest in the activities of our shipyard, we have devoted thousands of manhours in responding to your request for information and in providing time necessary for the Committee staff to interview our management and employees.

We have responded in a thorough and timely manner to each and every request made of us by the Committee. We have cooperated as we have because Ingalls has nothing to hide.

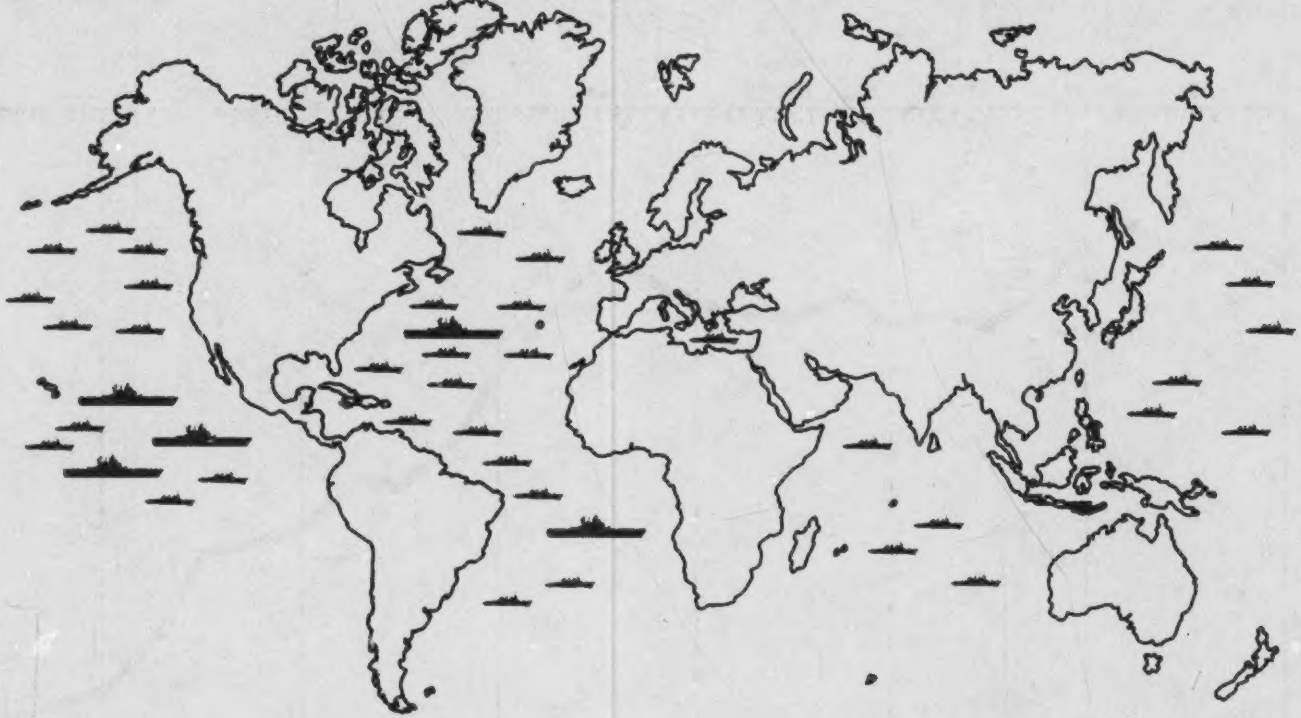
We are prepared now to respond to any questions the Committee may have about our company and the manner in which we conduct our business.

Thank you.



INGALLS SHIPBUILDING MAY 1977

Chart 1



INGALLS SHIPS DEPLOYED AROUND THE WORLD

Chart 2

EMPLOYMENT CHART

1977 – 1983

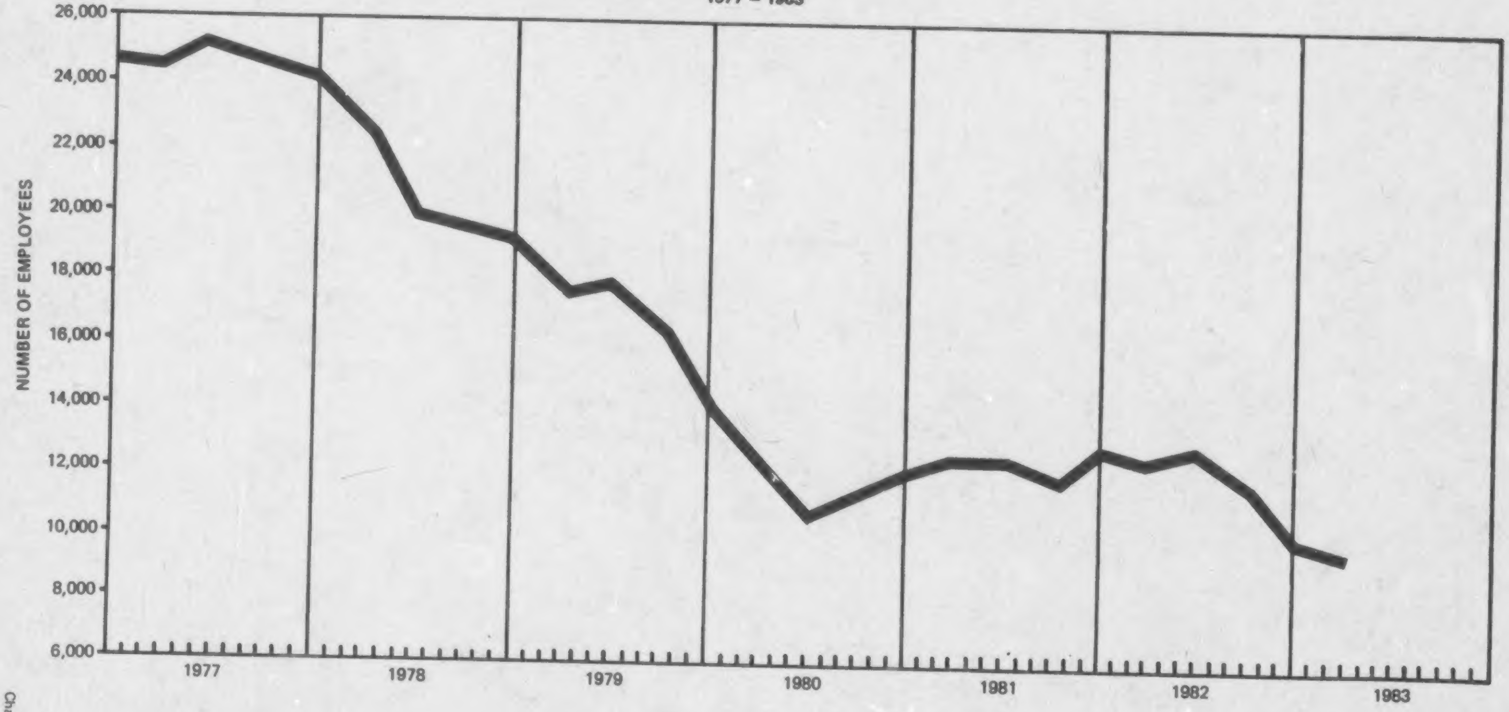
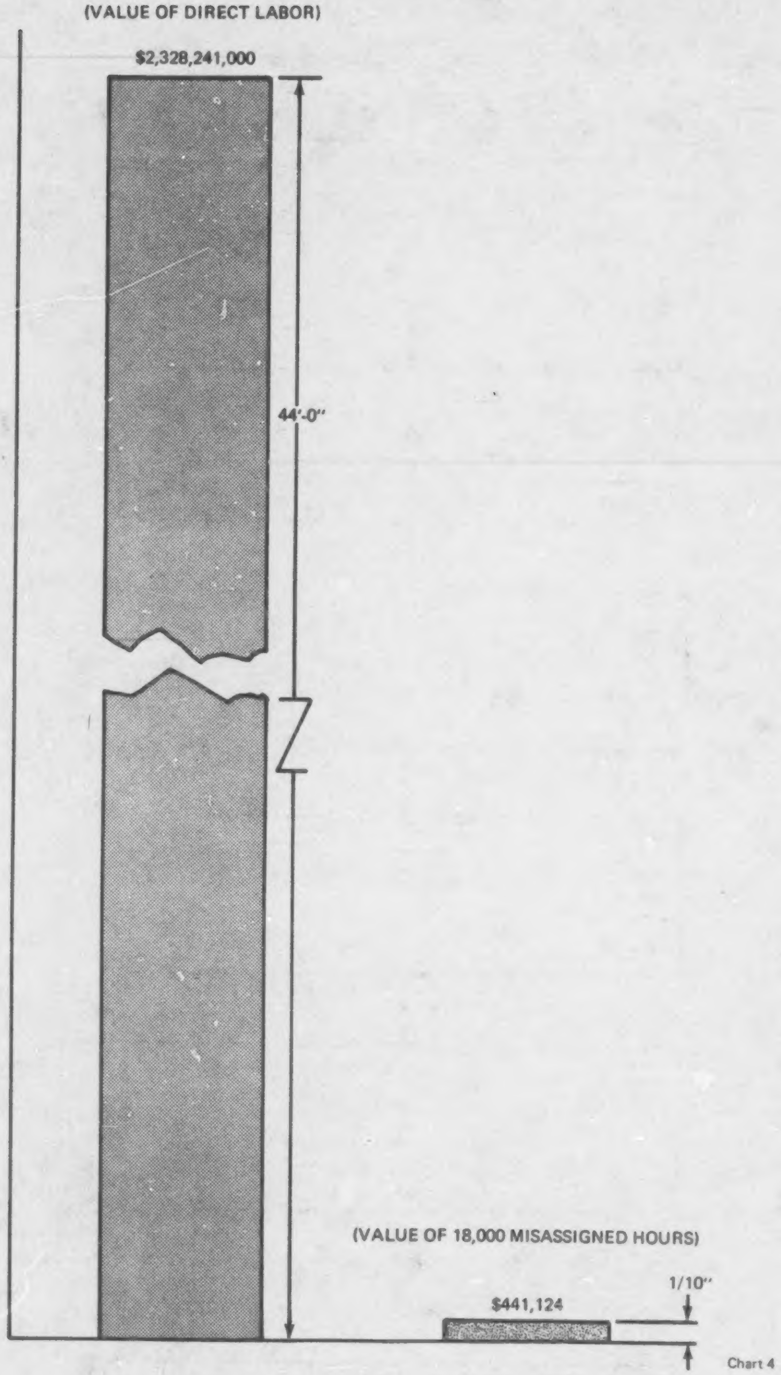


Chart 3

TOTAL SHIPYARD



INGALLS MANAGEMENT STRUCTURE

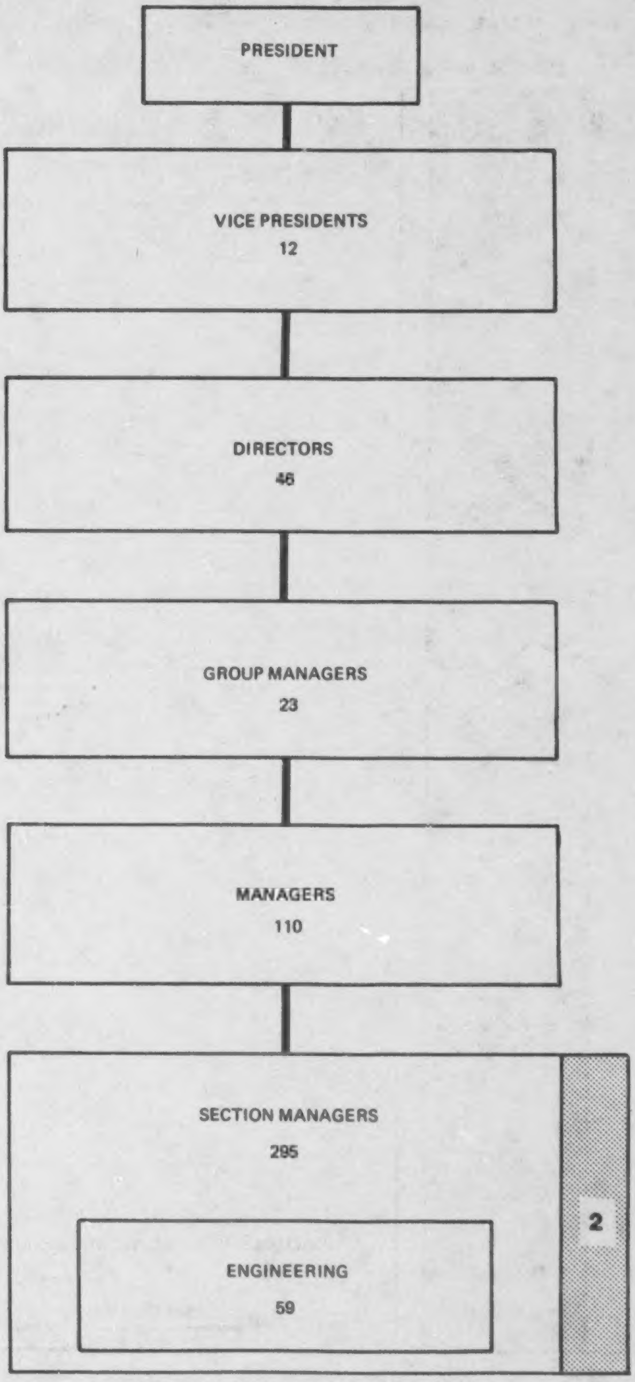
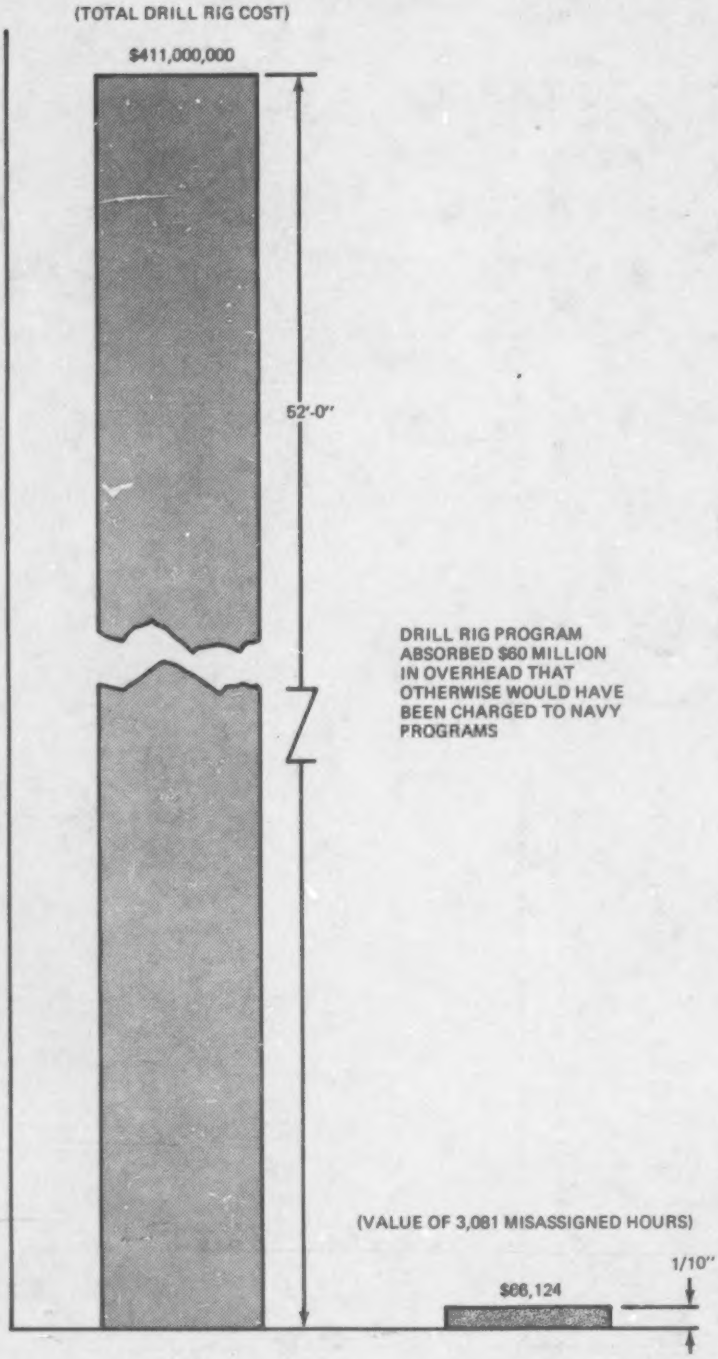

PRESIDENT
VICE PRESIDENTS
12
DIRECTORS
46
GROUP MANAGERS
23
MANAGERS
110
SECTION MANAGERS
295
ENGINEERING
59
2

Chart 5

(LEVEL WHERE MISASSIGNMENT OCCURRED)

DRILL RIG/NAVY
MISASSIGNMENT OF HOURS



DRILL RIG PROGRAM
ABSORBED $60 MILLION
IN OVERHEAD THAT
OTHERWISE WOULD HAVE
BEEN CHARGED TO NAVY
PROGRAMS

Chart 6

DRILL RIG/NAVY

MISASSIGNMENT OF HOURS

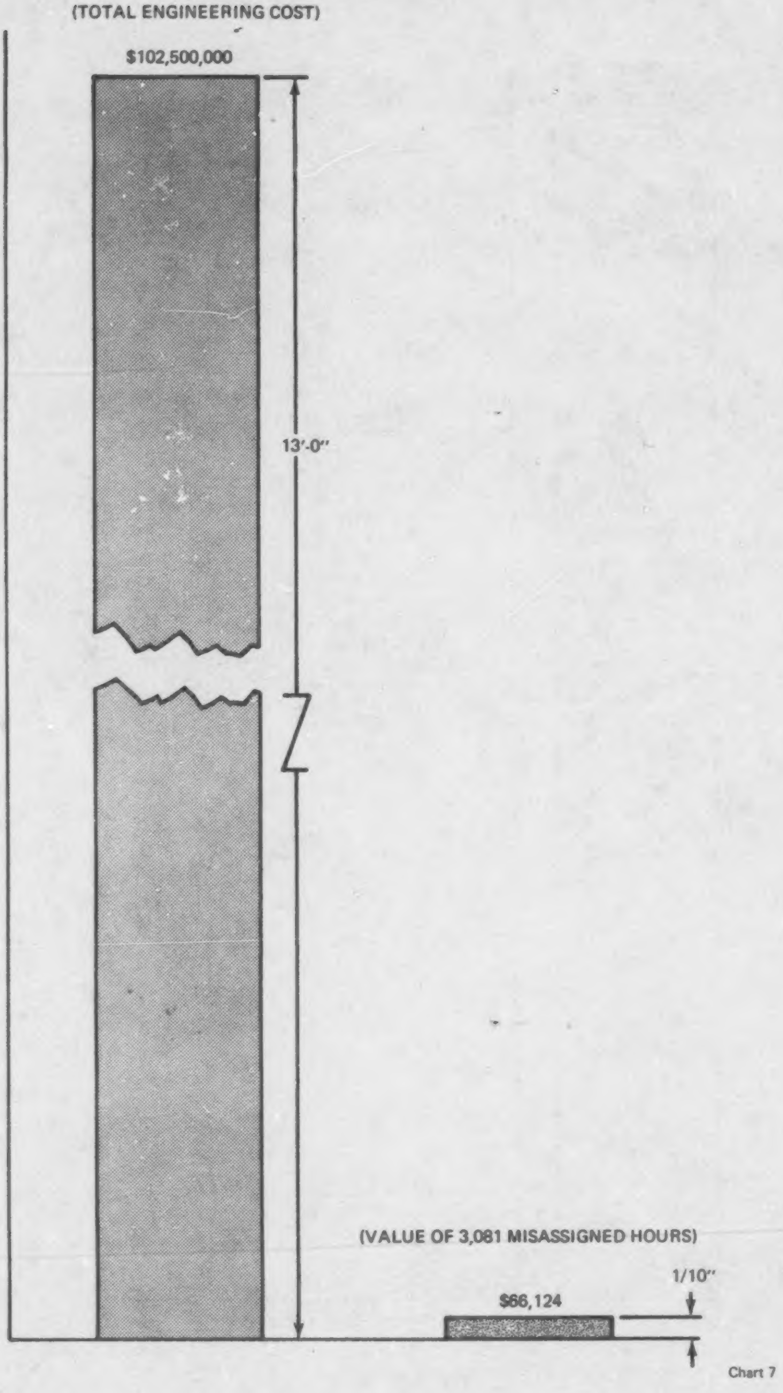


Chart 7

NAVY/NAVY

MISASSIGNMENT OF HOURS

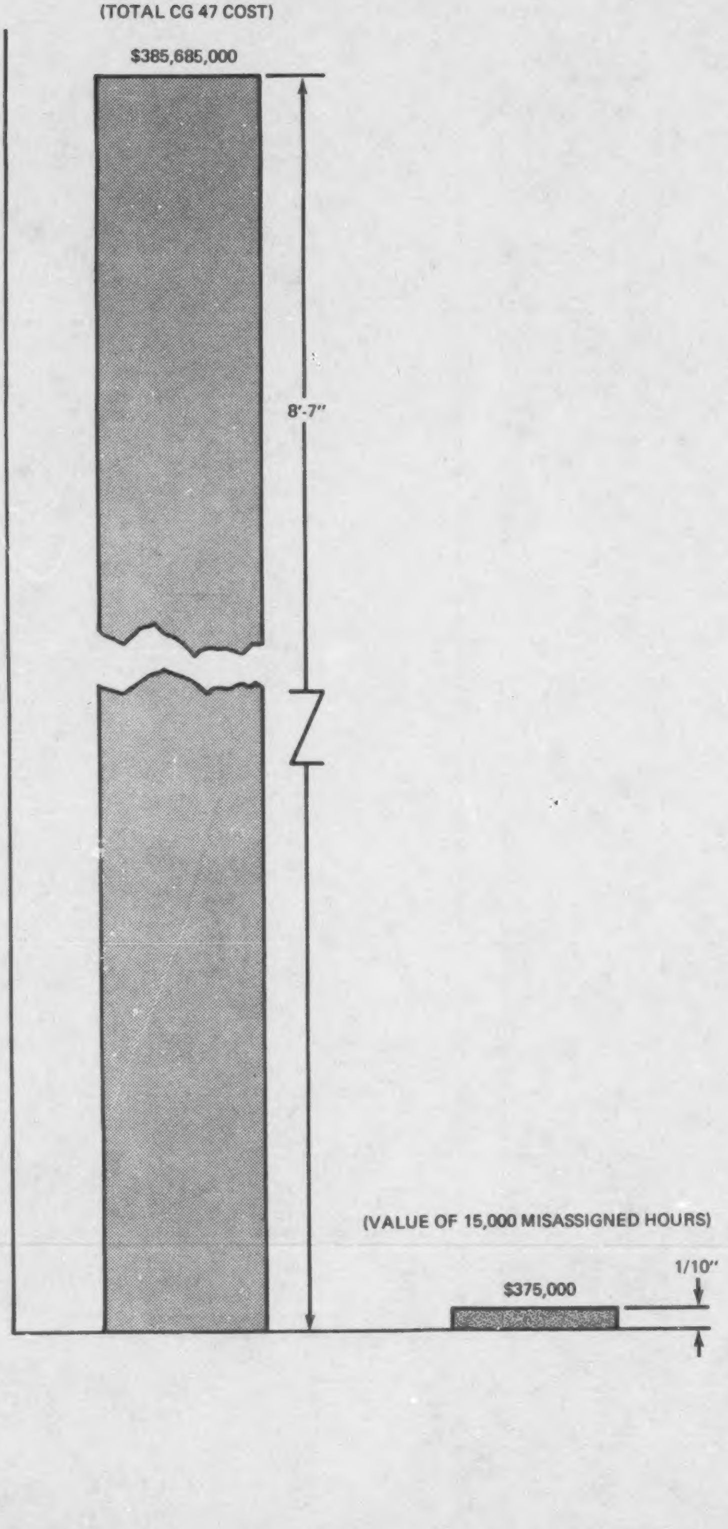


Chart 8

NAVY/NAVY
MISASSIGNMENT OF HOURS

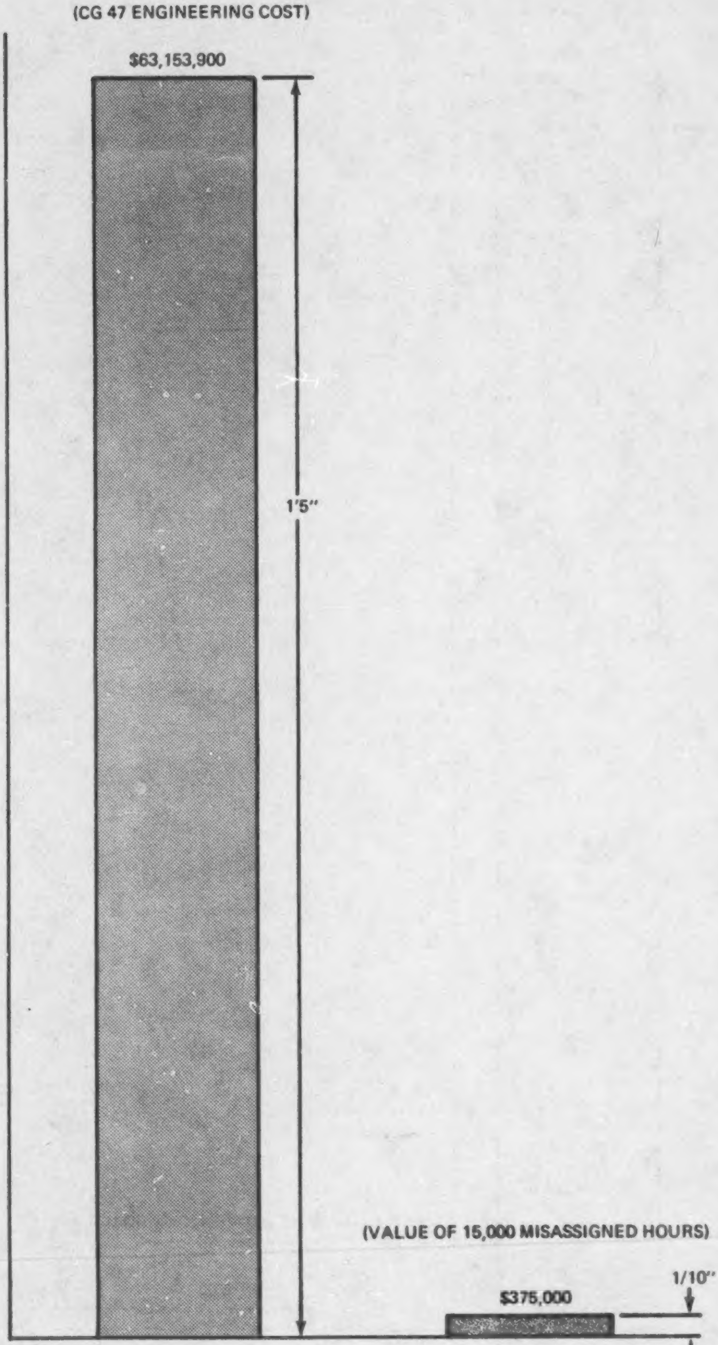
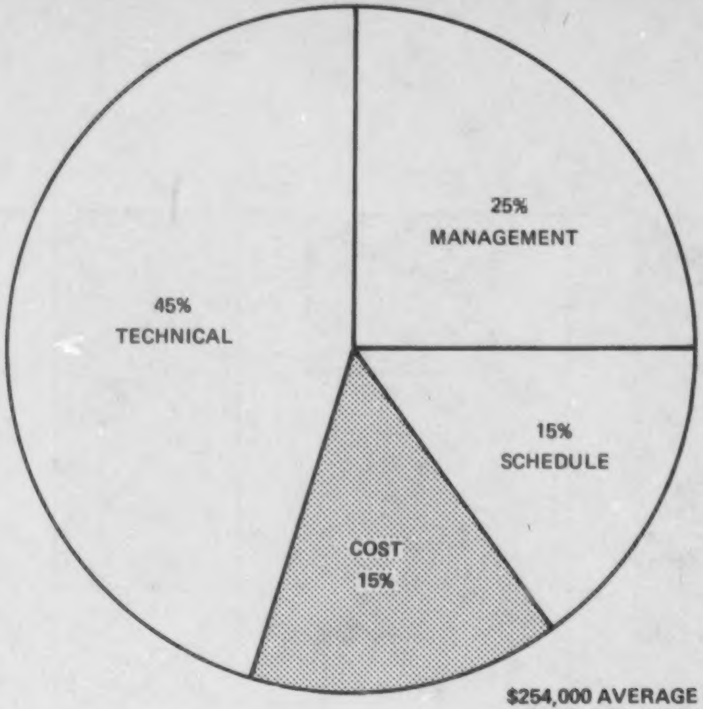


Chart 9

CG 47 AWARD FEE

BASED ON 18 QUARTERS

TOTAL AVAILABLE	$30,480,000
AVERAGE AWARD FEE PER QUARTER	$ 1,693,000



$254,000 AVERAGE QUARTERLY AWARD FEE ATTRIBUTED TO COST

Chart 10

993/997 CONTRACTS

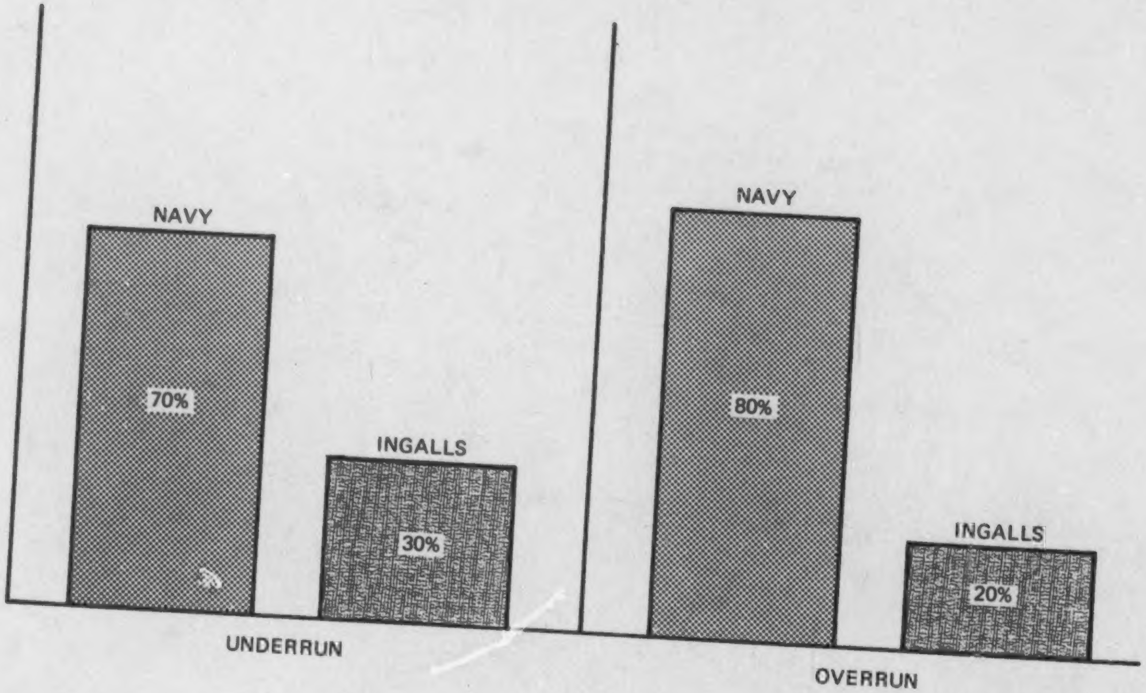
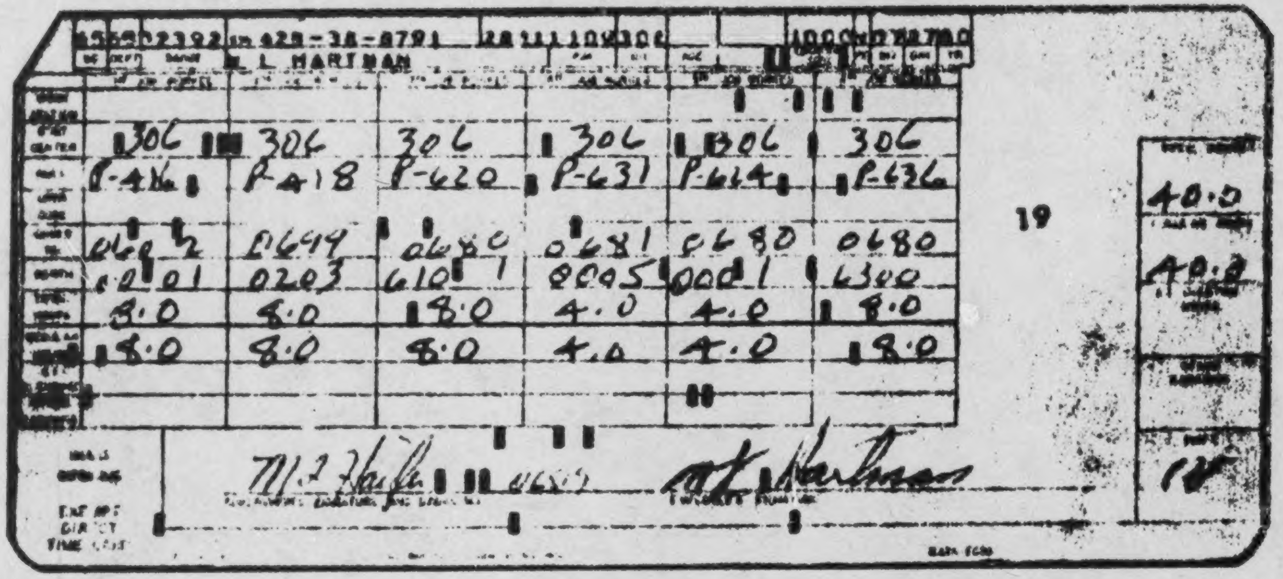


Chart 11



02392 428-38-8791 10 L HARTMAN

306	306	306	306	306	306
P-416	P-418	P-420	P-431	P-614	P-636
0662	0644	0680	0681	0680	0680
0201	0203	6101	8005	0001	6300
8.0	8.0	8.0	4.0	4.0	8.0
8.0	8.0	8.0	4.0	4.0	8.0

19

40.0

40.0

M.J. Haile

Hartman

Chart 12

TOTAL SHIPYARD

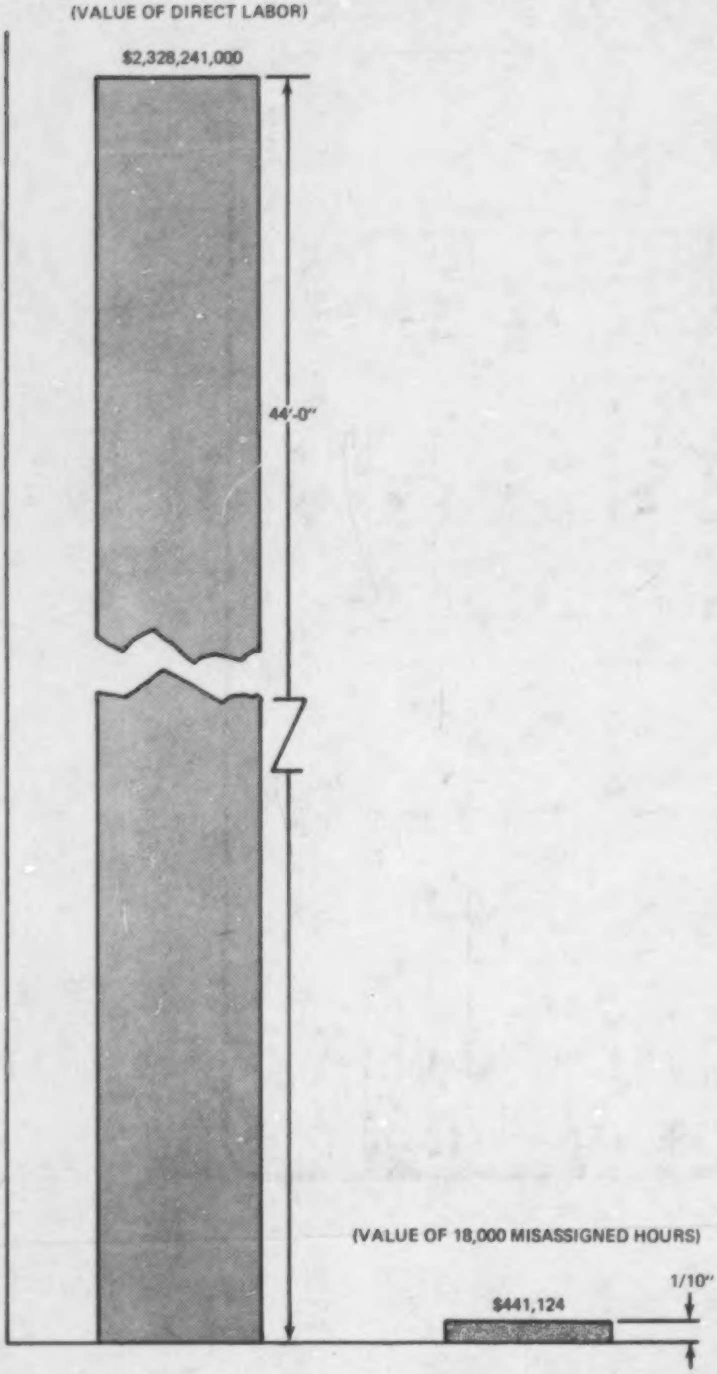


Chart 13

Department of Justice

PREPARED STATEMENT OF ROGER M. OLSEN

DEPUTY ASSISTANT ATTORNEY GENERAL

BEFORE THE

SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

CONCERNING
NAVY SHIPBUILDING CASES

ON

MAY 4, 1983

Mr. Chairman and Members of the Subcommittee: I am pleased to be here to discuss an important subject, the Department of Justice investigations into allegedly fraudulent claims in Navy shipbuilding. With me today is Richard Sauber, the Chief of the Defense Procurement Fraud Unit.

Over the last decade, the Department of Justice has investigated possible fraud in claims filed with the United States Navy by several major shipbuilders. After extensive investigations, the Department declined to prosecute Lockheed Shipbuilding and Construction Company and the Electric Boat Division of General Dynamics.* The Department has appealed the dismissal of the indictment against Litton Systems, Inc. d/b/a Ingalls Nuclear Shipbuilding Division. Because that matter is still pending, we cannot comment further on it.** Our experience in these and other procurement-related cases revealed that the Department of Justice needed to develop greater expertise to handle defense procurement-related cases effectively.

Let me begin by addressing the role of the Department of Justice in the government procurement process. The Department pursues civil and criminal remedies in order to maintain the integrity of government spending programs. Overall, a very small number of government procurement transactions involve conduct suitable for criminal prosecution. Nevertheless, since fraud by even a small number of defense contractors in a small number of transactions can inflict damages in the millions or hundreds of millions of dollars, it is important that we vigorously pursue criminal penalties in appropriate instances. It is appropriate to bring a criminal prosecution only when we believe that the conduct under investigation constitutes a federal offense and that the admissible evidence probably will be sufficient to obtain and sustain a conviction.

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* The Department also declined to prosecute Bath Iron Works.

** The Newport News Shipbuilding matter is also still pending, and is, therefore, subject to the same restrictions on disclosure.

The Department Of Defense (DOD) Procurement Fraud Unit

Last year, Attorney General William French Smith and Secretary of Defense Caspar W. Weinberger agreed to establish a special investigative and prosecutive unit, based in Northern Virginia, to concentrate its attention on both fraud and corruption in defense procurement.

The unit, which is now in place, will itself conduct nationally significant investigations and prosecutions of matters that seriously compromise the integrity of the defense procurement process. It will also monitor Defense Department referrals to the Department of Justice as a whole, and thus be able to detect patterns of fraud against the procurement process. In addition, the unit will provide technical assistance and guidance to U.S. Attorneys' Offices handling defense procurement cases.

Although the primary objectives of the unit will be criminal investigation and prosecution, the unit will make special efforts to incorporate civil and administrative remedies into its enforcement efforts, maintaining at all times the needed separation between the criminal and civil processes. Cases will be continually reviewed to ensure that the Department applies the most effective remedies to contracting problems.

The staff of the unit presently includes experienced attorneys from the Criminal Division, the U.S. Attorney's Office in the Eastern District of Virginia, and the Civil Division. Several attorneys are now detailed from the Department of Defense to provide procurement expertise and additional prosecutive resources.

We have structured the unit so that it can draw on the expertise and manpower of the FBI and of all relevant investigative and audit agencies of the Department of Defense, including the Defense Criminal Investigative Service, Air Force Office of Special Investigations, Naval Investigative Service (NIS), Army Criminal Investigation Command, Defense Audit Service, Defense Contract Audit Agency (DCAA), Army Audit Agency, Naval Audit Service, and Air Force Audit Agency.

The unit is already actively investigating and prosecuting a number of defense procurement fraud cases, including a number of investigations into significant allegations of mischarging by members of the contracting community. The unit is working closely with DCAA to develop better techniques, including computer applications, to detect and investigate mischarging.

Two other developments may enhance our enforcement efforts against defense procurement fraud. First, President Reagan signed into law last year the Victim and Witness Protection Act of 1982 (P.L. 97-291, 96 Stat. 1248, 18 U.S.C. 3579), which allows restitution in all cases prosecuted under Title 18 U.S. Code. Such restitution is an important new remedy available when the government is the victim of procurement fraud. Second, the law enforcement plans, prepared in conjunction with the Law Enforcement Coordinating Committees (LECCs) in every federal judicial district, provide a vehicle for targeting procurement fraud in those districts in which the government spends large amounts for defense purchases.

Let me now turn to the Justice Department's experience with the shipbuilding claims cases.

The Department's Experience with Navy Shipbuilding Claims Matters

Understanding the Department's experience with these referrals requires an appreciation of how the claims process operates.

The Navy often awards shipbuilding construction contracts before all the detailed working plans for the construction have been developed, and invariably modifies specifications for the design and construction of ships. Such Navy actions frequently result in additional costs for the shipbuilder, and often lead to claims for equitable adjustment. A shipbuilder, who may work on more than one Navy contract at a time, may accumulate claims on one or more contracts and present them to the Navy as one consolidated, or omnibus, claim. An omnibus claim may be for hundreds of millions of dollars and may be, and in fact usually is, filed years after the Navy awarded the contracts on which it was based.

When the Navy receives a claim, it assembles a team of technical experts to review it and recommend a settlement amount, which is then subject to sometimes multiple reviews within the Navy itself.* While the claims process can settle disputes arising out of the contract as written, P.L. 85-804 (50 U.S.C. 1431) provides for relief through modification of the contract, and contractors may seek 85-804 relief in conjunction with a claims settlement. As the cases referred to us demonstrate, the Navy's claims review process is very time-consuming.

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* If the Navy and the contractor cannot agree on a settlement amount, the contracting officer issues a decision that the contractor may appeal. At the time of the Lockheed and Electric Boat claims, litigation on the contracting officer decision could go forward before the Armed Services Board of Contract Appeals and the Court of Claims. The procedures for litigating contracting officer decisions has since been somewhat changed by the Contract Disputes Act (41 U.S.C. 601 et seq.) and the Federal Court Improvement Act of 1982 (P.L. 97-164, 96 Stat. 25).

Between late 1968 and early 1969, Lockheed filed claims with the Navy for approximately $160 million, based on contracts awarded from 1963 to 1965. The Navy referred the claims to the Justice Department in late 1974. The claims process completed its review of the claims with an Armed Services Board of Contract Appeals decision in 1975. The Department of Justice declined prosecution in the fall of 1979.

The Electric Boat claim that became the subject of the criminal investigation was for about $544 million and was based upon contracts the Navy awarded in 1971 and 1973. Electric Boat filed the claim in December 1976. The Navy referred the matter to the Department of Justice in February 1978 for criminal prosecution. Shortly thereafter, in the summer of 1978, the claim was settled by the Navy in conjunction with an award of extra-contractual relief. Pursuant to P.L. 85-804, the Navy had notified Congress of its intention to grant the extra-contractual relief, which would have been blocked had either house of Congress passed a resolution of disapproval. The Department of Justice declined prosecution in December 1981.

The Department of Justice declined to prosecute Lockheed and the Electric Boat Division of General Dynamics after lengthy and thorough investigations revealed insufficient evidence of criminal fraud. A team of investigators examined each case, and each investigation was supervised by the Criminal Division.

Lessons Learned

In our shipbuilding claims investigations we found that:

- Because years had elapsed since the construction of the ships and the submission of the claims, memories of witnesses had faded and, in a few instances, key individuals had died.
- The division of responsibility within each shipyard made it difficult to identify employees who had complete knowledge of the questionable parts of the claims, and who could be held accountable for their accuracy.
- The participants in the claims process viewed the process largely as a negotiation in which extreme positions would be taken for bargaining purposes.
- The claims were prepared by expert lawyers, who knew how to establish extreme bargaining positions by inventive use of cost estimates and legal and accounting theories, and without the need for deliberate misrepresentation of facts.
- The technical and accounting issues raised in claims investigations often promised battles of experts at trial that would have made it difficult, if not impossible, to convince a jury of laymen that the government had presented proof beyond a reasonable doubt.
- The provision of P.L. 85-804 relief in a claims settlement could complicate criminal prosecution.

In addition to the usual problems often encountered in complex fraud investigations, then, we found that certain characteristics of the claims process undermined the assumptions of a false claims or false statements case -- namely that the defendant has made false statements of fact and that the government has relied upon them as true statements of fact. We came to appreciate that a criminal fraud prosecution cannot address all of the perceived problems in the claims process.

Based on our experience in these investigations, we have also concluded that, to the extent possible, there should be a core of attorneys and investigators assigned for the duration of a claims investigation, and the attorneys and agents should have experience in large document cases. We believe that the DOD Procurement Fraud Unit, with its experienced attorneys and investigators, as well as its pool of technical experts, would effectively staff such a case in the future.

Looking to the Future

The DOD Procurement Fraud Unit, because of the way it is structured, should be able to learn of future claims cases earlier and screen the cases to determine whether they have criminal potential. In making these determinations, the unit can apply two of the principles learned from the Department's experience with earlier shipbuilding cases:

- A criminal investigation should not be a second claims analysis, but is appropriate when the Navy's administrative process for evaluating the claim has been obstructed or corrupted by such things as deliberate lies or bribery.
- A criminal investigation should, early on, consider whether actions in the claims process argue against prosecution.

If the unit chooses to undertake new investigations, it will benefit from additional management controls instituted by the Department. These controls should ensure greater supervision of such investigations, high level attention to staffing needs, greater investigative focus, and tighter schedules.

The DOD Procurement Fraud Unit is a significant improvement, we believe, in structuring the respective contributions of the Departments of Justice and Defense in investigating allegations of procurement fraud or corruption. While it cannot solve all of the perceived problems in the Navy claims process, we believe that the Defense Procurement Fraud Unit, with its permanent staff and expertise, will be able to address complex procurement cases more effectively and efficiently.

Thank you. I will be happy to answer any questions you may have.

BIOGRAPHY

GEORGE A. SAWYER
ASSISTANT SECRETARY OF THE NAVY
(SHIPBUILDING AND LOGISTICS)

On 19 May 1981, President Reagan announced the selection of George A. Sawyer to be the Assistant Secretary of the Navy for Shipbuilding and Logistics. He was confirmed by the Senate on 16 June 1981 and took the oath of office on 23 June 1981.

Mr. Sawyer is a 1953 graduate of Yale University and has been associated with major marine, engineering and construction projects for many years.

While serving with the U. S. Navy, Mr. Sawyer was an early participant in the nuclear submarine program, including the prototype development and initial service operation of the first multi-nuclear propulsion installation.

In 1963, Mr. Sawyer joined Babcock & Wilcox as Nuclear Power Coordinator - Marine Projects, where he was involved in the development and application of the NS SAVANNAH and other nuclear ship projects. He is a co-inventor of the Consolidated Nuclear Steam Generator. He subsequently held the position of Manager, Marine Systems with NUS Corporation and Batelle Memorial Institute.

In 1969 he joined Bechtel Incorporated as Manager of Environmental Systems and held a number of management positions with that Company. His last position was as Manager of Eastern Operations and Vice President of International Bechtel Inc., responsible for Bechtel's port and other major transportation projects in the Middle East.

Mr. Sawyer served as President and Chief Executive Officer of John J. McMullen Associates, Inc., from September 1976 to April 1981.

He is the author of several technical papers. He is a member of the American Society of Naval Engineers and the Society of Naval Architects and Marine Engineers, and is on the Committee on Nuclear Applications of the American Bureau of Shipping. Mr. Sawyer also served on the Board of Directors of the Shipbuilders Council of America.

He was born on 20 April 1931, in New York. He is currently residing in Alexandria, Virginia.

September 1982

PREPARED STATEMENT OF THE HON. GEORGE A. SAWYER

ASSISTANT SECRETARY OF THE NAVY

Mr. Chairman and Members of the Committee, I am George A. Sawyer, Assistant Secretary of the Navy for Shipbuilding and Logistics. I am appearing before you today to discuss Navy procurement practices and policy, contractor performance, and Government oversight of the shipbuilding process. With me today are VADM Earl B. Fowler, the Commander of the Naval Sea Systems Command, RADM Wayne E. Meyer, AEGIS Shipbuilding Project Manager, and Captain P. D. Hoskins, the Director of the Naval Investigative Service. Together, we are prepared to address the areas delineated in your April 21, 1983 letter to the Secretary of the Navy.

Navy oversight and administration of shipbuilding contracts are conducted by a number of organizations, primarily the Naval Sea Systems Command (NAVSEA) and Supervisors of Shipbuilding, Conversion and Repair (SUPSHIPs), which are assisted by the Defense Contract Audit Agency (DCAA). Additionally, on contracts for nuclear powered ships, the Department of Energy and the Nuclear Regulatory Commission also will be involved in administration of contract compliance.

NAVSEA maintains overall management, engineering and procurement responsibility regarding Navy shipbuilding. While all shipbuilding contracts are awarded by NAVSEA, upon contract award, most administrative functions are delegated to the appropriate SUPSHIP. The SUPSHIPs themselves are a part of the Naval Sea Systems Command; and its Supervisors, who are naval officers, report to VADM Fowler as Commander of the Naval Sea Systems Command.

There are sixteen SUPSHIPs assigned responsibility for shipbuilding and repairs performed by contractors in specified geographical areas. SUPSHIPs Bath, Groton, Newport News, and Pascagoula are cognizant, respectively, of Bath Iron Works, Electric Boat, Newport News Shipbuilding, and Ingalls Shipbuilding Division. Likewise, DCAA is generally organized on a regional basis; however, DCAA also has single dedicated offices providing support to the four mentioned SUPSHIPs.

The SUPSHIPs vary in size, with the largest having in excess of 490 people and the smallest with 42 people.

TABLE 1.
Manning Levels, Supervisors of Shipbuilding, Conversion and Repair

SUPSHIP	1983	1982	1981	1980
BATH	261	245	225	190
BOSTON	340	343	365	410
BROOKLYN	190	180	187	181
CHARLESTON	167	152	150	122
GROTON	412	410	430	408
JACKSONVILLE	197	180	192	165
LONG BEACH	185	170	163	162
NEW ORLEANS	106	96	95	83
NEWPORT NEWS	434	434	415	388
PASCAGOULA	395	350	326	326
PEARL HARBOR	42	44	41	41
PORTSMOUTH	442	430	420	360
SAN DIEGO	497	490	444	421
SAN FRANCISCO	308	308	293	279
SEATTLE	353	351	350	305
STURGEON BAY	47	42	44	43

The size of the SUPSHIPs office is based on the number, dollar value and complexity of contracts being administered. SUPSHIP Pascagoula, for example, has approximately 395 personnel and is responsible for contract administration of all the Navy contracts with Ingalls Shipbuilding Division.

Specifically, contract administration functions performed by the SUPSHIPs include all those listed in Section 1-406 of the Defense Acquisition Regulation. The SUPSHIPs are tasked, among other things, to ensure compliance with all contract terms and conditions and specifications, negotiate prices of and execute contract changes, certify progress payment invoices, administer Government property under the contract, negotiate overhead rates and conduct inspections of the work performed under the contract. To accomplish this responsibility, SUPSHIPs are organized into various departments. For example, SUPSHIP Pascagoula has a Repair Department concerned with ship overhauls, an Engineering Department, a Quality Assurance Department, a Contracts Department, a Material Department, a Legal Department, and a Business Review Organization. There are also project offices for each major ship class being constructed or overhauled at the SUPSHIP.

DCAA is organized primarily to perform financial type audits. One of DCAA's major functions is to provide assistance to the Contracting Officer by conducting audits and reviews and providing other information. DCAA reviews essentially fall into three categories: pricing reviews, operational/functional reviews, and reviews that are specifically required by contract. Pricing reviews are audits of contractor proposals for new contracts and changes to existing contracts. Operational or functional audits are audits of organizational elements of the contractor's operation without regard to specific contractual requirements. Audits of payroll operations, the paint shop or the steel fabrication shop are examples of functional audits. Audit effort required by the contract itself, for example, includes verifying allowable costs incurred for purposes of progress payments or for close-out of contracts which require final determination of allowable costs. During the administration of any large defense contract, DCAA can be expected to issue a number of reports identifying errors, inconsistencies, or irregularities of an administrative or non-criminal nature which are routinely resolved between the Navy's contracting officer and the contractor.

For example, the DCAA office at Ingalls Shipbuilding Division has issued an average of 115 audit reports per year over the past four years. While many of these are pricing audits not concerned with remedial or corrective action, many are operational or functional audits concerned with Ingalls conformance with various laws, regulations, contract requirements, or the accuracy of their overall accounting systems and procedures. Over the 26 month period between July 1980 and September 1982, DCAA conducted 56 specific "floor checks" of ISD's time charging methods at various cost centers, a rate of over two per month.

In addition to these organizations, various investigatory agencies may become involved during contract administration, as, for example, the Federal Bureau of Investigation (FBI), the Defense Investigative Service (DIS), and the Naval Investigative Service (NIS). While these investigative agencies perform no routine reviews regarding the procurement process and contract administration, these and other criminal investigation agencies do become involved when requested and when there is actual, suspected or alleged criminal conduct on the part of anyone associated with the effort. This can occur in any number of ways; e.g., from hotline calls to DCAA reviews that reveal suspect circumstances to internal reviews by Inspectors General, to the contract administrator (SUPSHIP) requesting an investigation. Information from an NIS, DIS or FBI investigation occasionally points the way for further DCAA audit or action by the SUPSHIP.

Among the investigations conducted have been a number based upon alleged criminal activities involving Ingalls Shipbuilding Division personnel, ranging from investigations of simple theft to "white collar" type criminal activities. Several of these ultimately have been accepted for prosecution by the Department of Justice and other authorities; punishments administered have included fines and even imprisonment. Significantly, many of these investigations were initially investigated and subsequently referred to the authorities by Ingalls own Security Department.

Several investigations are now ongoing and, in fact, two indictments recently were handed down in connection with one of these investigations. However, I can say with assurance that in no case have we seen any evidence of a consistent, management-inspired effort to defraud the United States Government through mischarging of time, improper accounting of material or other illegal activity. The mischarging allegations appear to reflect situations which are indicative of the need for improved accounting systems which are being put into place and the need for continued vigorous surveilance to prevent deliberate fraud by contractor employees. I assure you that the Navy regards all evidence of waste, fraud and abuse as serious, regardless of the amounts involved. To this end the Naval Investigative Service manning levels have been increased at all of our field offices in order to be more responsive to the needs of the local commanders. We have and will continue to pursue all open investigations with vigor and agressively administer and audit contractor performance to ensure that the taxpayer's good money is spent judiciously and for the purpose intended - the defense of our country.

From time to time, the General Accounting Office (GAO) may also review shipbuilding procurements. Our contracts contain a provision providing for examination of contractor records by the Comptroller General.

The Navy makes use of the reports issued by DCAA, GAO, and criminal investigative agencies in various ways depending upon the nature and content of the report. For example, DCAA reports are routinely used by Contracting Officers in determining the reasonableness of a contractor's proposal for new contracts or changes to existing contracts. The functional reviews often form the basis for corrections to charges by the contractor and for requests for corrective actions in practices of the contractor. For example, during the period August 1980 to March 1983, a total of fifteen DCAA floor checks indicated that some corrective action was needed. In every case, Ingalls took corrective action to bring their procedures back into compliance. Along these same lines, GAO reports are used, when appropriate, to improve the procurement process by implementation of their recommendations. While criminal investigative reports are not routinely used by the Navy in the procurement process, when available and when warranted by the circumstances, these reports may be used to establish better procedures for the future. In addition, these investigations sometimes lead to the recoupment of costs that may have been improperly charged to the Government.

In addition to these reports, most shipbuilding contracts require both specific reports from the contractor and the conduct of program reviews in order to identify management systems and controls, and cost and schedule performance data. Contractors performing major weapons production are required to maintain extensive cost, schedule and performance data in accordance with procedures and formats set forth by Department of Defense Instruction 7000.2. Ingalls Shipbuilding Division has complied with this requirement, and, in fact, was one of the first of our major shipbuilders to develop a system and to have it certified by the Navy (in October 1977). A number of recertifications have been conducted since that time; the next is scheduled for May 1983. The effectiveness of these systems and actual performance data are routinely evaluated by the Navy. However, the ability of the Navy to influence the contractor to institute effective management systems and obtain early visibility of actual or potential performance problems is still a direct function of the type of contract involved in the particular program.

Ingalls presently has three contracts which provide for construction of six CG-47 Class cruisers. The first contract was awarded to Ingalls as a result of competition in September, 1978, and covered the detail design and construction of CG-47, USS TICONDEROGA. The second contract, which was awarded on a sole source basis, covers the construction of CG-48, YORKTOWN, and was awarded in April, 1980. YORKTOWN is now approximately 70% complete and is scheduled to be commissioned in July, 1984. The third contract, awarded in August, 1981, on a sole source basis, provided for the construction of two FY 81 ships, CG-49 and CG-50, and contained an option which was exercised by the Navy in January, 1982, for two FY 82 ships, CG-52 and CG-53.

One other CG-47 Class cruiser is under contract. CG-51 was awarded competitively in May, 1982, to Bath Iron Works Corporation, Bath, Maine.

Each of these earlier contracts for AEGIS class cruisers has been a cost-plus-award-fee (CPAF) type of contract. The Navy uses this type of contract typically in the developmental and initial production phase of a program where work scope definition is not precise and where the technical and management performance by the contractor is a paramount consideration. In view of the highly complex and evolving nature of the AEGIS cruiser design when those contracts were awarded, the CPAF contract type was considered appropriate through the FY 82 procurement. However, it is our strong and often avowed policy to utilize fixed-price type contracts (along with competition) wherever practicable. Accordingly, the FY 83 procurement of three cruisers will be made under a Fixed-Price-Incentive type contract; and commencing in FY 84 the two shipyards, Ingalls and Bath Iron Works, will compete on the basis of price.

As set forth in the Defense Acquisition Regulation, the cost-plus-award-fee type of contract provides for reimbursement of allowable costs incurred by the contractor in performing the contract and for a subjective evaluation of the performance of the contractor in areas identified in the contract to determine the amount of award fee earned by the contractor. Before I discuss these areas and how the actual award fee evaluation is conducted, I would like to briefly discuss the differences between this type of contract and other types of cost reimbursement contracts.

A cost-plus-fixed-fee contract provides that the Government will reimburse the contractor its allowable costs incurred in the performance of the contract. In addition, the contractor receives a fixed fee which does not change whether or not the cost of performance stays below or goes above the initially projected estimated cost of performance.

On the other hand, a cost-plus-incentive-fee contract provides for an adjustment to the fee earned by the contractor depending upon the actual allowable cost of performance. The contract establishes a target cost, a target fee, a minimum fee, a maximum fee, and a contractor-government sharing ratio. If allowable costs incurred in the performance of the contract are less than the target cost, application of the share ratio results in a higher fee to the contractor. If allowable costs incurred in the performance of the contract are greater than the target cost, application of the share ratio results in a lower fee to the contractor.

The cost-plus-award-fee contract usually has a base fee, which operates like the fixed fee in a cost-plus-fixed-fee contract, in addition to an award fee. In accordance with Defense Acquisition Regulation, the award fee is a specific amount which is set aside and is "earned" by the contractor based upon the evaluation by the Navy of the quality of the contractor's performance in areas identified in the contract. It should be noted, however, that the Navy evaluation is not only used to determine the amount of award fee earned by the contractor, but also provides an assessment from the Navy's perspective of the various aspects of the contractor's performance. This is useful both to the Navy and to the contractor and provides an opportunity for the contractor's management to alter areas of performance that may need additional management attention.

Each of the CPAF contracts for AEGIS cruisers contains four categories to be evaluated in order to determine the amount of award fee to be awarded the contractor for the evaluation period. These categories are Technical, Management, Schedule, and Cost. It is the Navy's evaluation of performance in each of these categories that determines how much award fee is earned by the contractor for the particular evaluation period. These evaluations have also taken advantage of the key feature of this type of contract; namely, a mechanism for feedback on contractor performance.

The actual award fee evaluation for each AEGIS cruiser contract is conducted on a quarterly basis by an award fee panel whose members include senior Naval officers and senior civilian personnel of the rank of Captain/GS-15 or above. Prior to the convening of the panel, the group has been briefed by the contractor regarding his progress. The actual award fee evaluation process commences with the assembly of the award fee panel. The president of the shipbuilder being evaluated is normally also present at the meeting. Individual Navy personnel then come before the panel to present and discuss a summary of their findings relative to the contractor's performance in their area of expertise during the period of evaluation. Specifically, each witness identifies those areas where performance has been good and those areas that need attention.

The contracts provide for the award fee official to establish the award fee. To this end, each award fee panel member establishes an adjective and a percentage rating for each ship or group of ships under contract for the evaluation period based upon the information presented. In addition, the award fee official also casts one vote which is of equal weight with the votes of each of the other panel members. Although the president of the shipbuilder also gives an assessment of his firm's performance, this is not included in determining the amount of award fee awarded to the contractor. These ratings are then approved by the award fee official who, in the case of the current CG-47 Class contracts, is Rear Admiral Wayne E. Meyer, the Project Manager.

The Contracting Officer thereafter prepares a modification to the particular contract to reflect the amount of award fee earned by the contractor for the evaluation period.

To date, the Navy has conducted 18 formal, structured reviews of Ingalls' performance on the CG-47 contract since its award in September of 1978. The two reviews remaining will carry through the guarantee period on USS TICONDEROGA.

Ingalls has done quite well; the awards have ranged from a low of 75% to a high of 95%, averaging nearly 85%. This award fee, combined with a 3% base fee as of April 19, 1983 has resulted in a total fee to the contractor of approximately 11.6% of cost incurred.

As mentioned previously, the Navy evaluates the contractor in four areas: Technical, Management, Schedule, and Cost. As to schedule, USS TICONDEROGA transferred to Navy custody six weeks ahead of the original schedule set more than four years earlier. Regarding cost, USS TICONDEROGA delivered within 3% of the budget established in 1975. While the 3% represents approximately $25 million, and that is certainly no small amount, we should remember that this highly complex and revolutionary lead ship was constructed during a period of unexpectedly high inflation.

From the management standpoint, Ingalls performed superbly. Ingalls readily took on board the design budget concept, which had never been used before and which directly resulted in USS TICONDEROGA being at sea at least a year and a half earlier than could otherwise have been achieved. This was accomplished with no increased cost or schedule slippage. Additionally, Ingalls worked around many circumstances which traditionally have caused cost increases and schedule slippages. Some of these were:

- a 6-month late Government delivery of one 5" gun;
- the destruction by fire of one MK 26 GMLS enroute to Pascagoula preventing timely delivery by the Government; and,
- an additional sea trial which permitted the conduct of test firings of all missile and gun systems to ensure structural integrity of the ship during the ship construction process - a Navy first.

Additionally, Ingalls accommodated extensive hands-on crew training, permitting USS TICONDEROGA to maintain her aggressive schedule to join the operating forces with a thoroughly trained crew. All of these efforts were accomplished as a direct result of the attention focused on USS TICONDEROGA by top management, while at the same time staying on schedule and within budget.

Technically, the ship itself is the best evidence of how Ingalls performed. Since commissioning, USS TICONDEROGA has been involved in an intensive work up program, successfully demonstrating all the elements of this fine combatant ship. The ship has repeatedly demonstrated her ability to exceed 30 knots in a variety of conditions. The ship is very stable and smooth riding in state 5 (extremely rough) seas. The ship conducted 13 consecutive successful SM-2 missile firings against a variety of target profiles, including multiple simultaneous targets and low elevation presentations. No target survived. Both guns were fired against surface targets, scoring 100% in intermediate and long range gunnery exercises. The HARPOON missile system was successfully fired against a surface hulk. The PHALANX close in weapon system and the electronic warfare systems were satisfactorily exercised, as were the communications data links and radio systems. The ship was tested on the acoustic range and found to be among the quietest ASW ships we have. Six successful torpedo and ASROC firings were made against target submarines.

Of course, Ingalls did not accomplish this alone; there were many other contractors and Navy activities, and most importantly, dedicated people involved to make it happen. However, in summary and retrospect, Ingalls has done an excellent job on the CG-47 contracts to date.

In conclusion, we believe that the performance of this shipbuilder - and that of the other major yards participating in naval ship construction over the last several years - has been generally good. We should remember that they are large industrial enterprises which employ a working population equal in size to some cities. As is the case in all large scale human enterprises, individual cases of waste or fraud exist, which may be motivated by criminal intent or through the exercise of poor judgment. The Navy has in existence workable systems both to administer and audit contractor performance, and to uncover and investigate instances of waste, fraud and abuse as they occur. These systems have been expanded over the past two years and are constantly being improved upon. In all cases where an investigation is warranted, the proper investigative authorities are notified and the matter is pursued. When possible federal crimes are to be investigated for prosecution, the Department of Justice is also involved.

I assure you that we are expending every effort to give the nation exactly what it has every right to expect, a prudent husbanding of the nation's resources and a dollar's worth of defense for every taxpayer's dollar we spend.

I stand ready to respond to your questions.

PREPARED STAFF STATEMENT

OF THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Mr. Chairman and Members of the Subcommittee:

In October of 1982, the Permanent Subcommittee on Investigations (PSI) was made aware of a number of allegations pertaining to contractor irregularities and failure of Navy oversight at the Ingalls Shipyard in Pascagoula, Mississippi, a division of Litton Industries. The initial allegations we received were presented to the Subcommittee by the Better Government Association (BGA) of Chicago, which had conducted preliminary investigative work at the Shipyard. Chairman Roth directed the staff to carefully analyze the allegations presented by the BGA and proceed immediately to begin an independent investigation of the serious charges that had been raised.

Chairman Roth's particular concern was the effectiveness of Navy oversight in view of the billions of dollars budgeted to Ingalls and others throughout the country for ship construction and overhaul. The scope of the issues is nationwide and they are not problems limited to a particular contractor. We discovered what may be serious institutional problems both for the Navy and for our "watchdog" agencies, the Defense Contract Audit Agency (DCAA) and the Department of Justice (DOJ).

Our investigation has involved the review of thousands of pages of documents and the interview - and in many cases, the reinterview - of dozens of individuals, including past and present employees of Ingalls, current and former naval personnel, representatives of DCAA, DOJ, other government agencies and private citizens. Quite understandably, Ingalls was not eager to volunteer information which might reflect badly on the company. Nevertheless, company management cooperated fully in providing us with all documents and employees we requested. The assistance provided by the cognizant government agencies was, in varying degrees, actually somewhat less cooperative.

Along the way, the investigation succeeded in demonstrating that a number of charges concerning the shipbuilding program in Pascagoula were unfounded. Others are still pending investigation. Some, however, appear to have a basis in fact and are of a scope which justifies this Subcommittee's attention.

Specifically, we discovered that the building and buying of Navy ships is subject to conflicting rules and priorities. For both the Navy and for Ingalls Shipbuilding, there are two sets of policies and agendas.

For the company, there are official policies, coexisting with an unwritten set of rules dictated by the harsh economic realities that govern the company and its employees. In the Navy's case, the twin missions of military effectiveness and fiscal prudence exist as official equals. Yet, the staff has observed that the Navy often seems to push cost considerations to low-priority oblivion in the interests of getting the next ship out to the fleet.

The most serious matter our investigation disclosed was the regular, systematic mischarging of labor by Ingalls employees. As the term is used here, "mischarging" means the billing of work performed on one ship contract to the budget of another. This has the obvious consequence of artificially deflating the cost of the ship on which the work is actually performed and simultaneously inflating the cost of the ship to whose budget the charges are shifted.

Mischarging can occur in a number of situations, with a variety of results. In one type, work performed on a fixed-price contract that is in danger of running over its budget can be charged to a cost-type contract. This has the result of obtaining full payment via the latter, which provides for reimbursement of costs as incurred, keeping the costs on the former under the fixed ceiling, and getting the work done. The only loser is the customer on the cost-type contract, who has paid for work done on another customer's job. The Navy fell victim to just that scenario when, based on alleged fraudulent mischarging by Ingalls, it paid for work actually performed on fixed-price commercial oil rigs but billed to the Navy cost-type ship contracts. The matter was recently settled for $137,000. While the sum is relatively small, the case is extremely significant in a number of respects.

First, it involved the company's implicit admission that, despite a formal policy to the contrary, employees had deliberately engaged in systematic mischarging solely because of budgetary pressure. Secondly, the company's response upon learning of the allegation almost two years ago was that a full internal investigation revealed "erroneous charges" of less than $20,000, less than one sixth of what it finally agreed to, an example of what may be a persistent problem for Ingalls - the underestimation of such schemes. Finally, in the passage of more than eighteen months between accusation and settlement, we see an illustration of the Justice Department's ineffectiveness in policing such matters. It is noteworthy that the eighteen month delay involved no visible progress by

Justice after formalities of the first few weeks. The facts underlying the larger settlement were developed by this Subcommittee's investigation, and it is reasonable to conclude that both the fact and the timing of the settlement are products thereof.

A second form of mischarging discovered at Ingalls involves the assignment of labor charges to available budgets, without regard to the jobs on which the work was actually performed. In the instance examined by PSI staff, this was accomplished by pre-planned charging directives, apparently prepared solely on the basis of available budget. An example of one from the material section of Ingalls is submitted as an exhibit. At the very least, this type of artificial billing completely destroys the accuracy of labor cost data, a vital component of current procurement policy. All parties agree to the essentiality of accurate cost data (see Ingalls' statement entitled "Background: Essentiality of Time Charging", provided to the Subcommittee by Ingalls' letter of March 21, 1983 and submitted as an exhibit; see also DCAA Audit Report No 1421 - 1C130122-0 re: Ingalls Shipbuilding) The current Defense Department campaign to improve procurement policy, as enunciated in the "Carlucci Initiatives", rests squarely on a presumption of accurate cost data. Congress has given the requirement for accurate cost data the force of law in the "Truth in Negotiation Act", P.L. 87-653. Yet, when its employees have been caught in the act of sabotaging this cornerstone of procurement policy, Ingalls has generally failed to discipline them and has not been effective in halting the practice.

The third type of mischarging discovered by PSI is the gravest, both in its nature and its scope. This mischarging took the form of planned, systematic, and calculated charging of work performed on the U.S.S. Ticonderoga (CG-47), the first of this country's "Aegis" cruisers, to other ships in the yard. Called "cross-charging", this scheme was planned in that it was undertaken by management personnel after review of available of funds in different budgets. It was systematic in that it was applied to the full work force under these management personnel and orchestrated to mesh with the legitimate work going on in their area. Finally, it was calculated in that it was designed to achieve maximum budgetary advantage on the CG-47 while doing minimum fiscal damage to the budgets actually being charged.

This cross-charging scheme occurred in the Piping Design shop. Piping is recognized industry-wide as the one of the most expensive construction elements in shipbuilding, second only to steel erection. Thus, problems in the piping area are serious problems, in terms of both design and budget.

The Piping Design cross-charging scheme was a simple one. As described in the sworn testimony to PSI staff of some of its participants, whose depositions are submitted as exhibits, the scheme ran for some two and a half years, involved at least two and possibly more levels of management, and accounted for up to 20% of the hours of approximately thirty-five full-time piping designers (approximately 30,000 hours). The company itself has suggested a figure of approximately 10,000 - 15,000 hours. One employee participant estimated the total worth of the mischarged hours to be in excess of $1 million.

These thousands of hours were worked on the CG-47, but were systematically shifted to the budgets of other jobs in the Piping Design shop (principally destroyers, known as "DD's"). These DD budgets were underrunning and the surplus budget was seen as a convenient place to dump the CG-47 work which otherwise might have shown up as a cost overrun on the CG-47.

To suggest that, since all of the funds for the ships originated with the Navy, this is merely a case of "robbing Peter to pay Paul" is to overlook the serious consequences of the cross-charging scheme.

The artificiality of the labor costs cut two ways: first, the actual cost of completing the work on the CG-47 was artificially reduced. Therefore, because cost estimates for future procurement rely in large part on accurate historical cost figures from similar work, therefore, the estimates for work on subsequent CG-47 class cruisers are tainted by this false accounting. This is enormously significant in that the Navy plans to purchase some fourteen cruisers of this type during fiscal years 1984 through 1988, at a total cost of at least $9.6 billion. According to the Congressional Research Service, this is the single largest line item among Navy ship categories during those years. Ingalls has already been awarded contracts to construct five of these ships in addition to the CG-47, which went into service in January of this year.

The importance of the construction of this ship class to the future of Ingalls Shipbuilding was not lost on the typical employee. The men who carried out the Piping Department cross-charging scheme did so specifically to avoid going over budget on the yard's highest priority job, the CG-47. Conversely, the DD-993 class ships and the DD-997, from which budget was moved, were the end of a previous generation of ships. Thus, budget was readily available because of the economy generated by a well-established learning curve and cost performance was not the critical priority it was on the CG-47. It was an ideal situation for cross-charging, and it occurred as the necessity arose. In the corrected deposition testimony of one of the participants:

> ...when the department totals were tabulated, (my supervisor) found out we were "X" number of heads over budget on the CG-47. He called a staff meeting and told all present that, "I don't know who is over but we must fix it". As the meeting broke up, I told him I had the time cards filled out and would have to change time cards to fix it. He said, "Do what it takes".

The appearance of effective cost performance was not Ingalls' only benefit from cross-charging. The CG-47 construction contract was what is known as a "cost plus award fee" contract. This contract form, described more fully below, assurred that on a quarterly basis Ingalls would be reimbursed the full value of its costs up to a contract ceiling, and in addition, would receive its profit ("award fee") in an amount reflecting the Navy's evaluation of its performance in that quarter. Cost performance is one of four major criteria in the Navy's evaluation. Therefore, the better Ingalls' performance (or appearance of performance) the higher its profit. During the period that members of the Piping Department have admitted cross-charging (i.e., June 1979 through the end of September 1981), Ingalls received award fees - profit - of almost $21 million. Obviously not all - or even a large part - of this sum can be proved to rest on inaccurate data. The fundamental point, however, is that cost data is crucial to all decisions - award fees, future procurement and so on - which demand an accurate data base.

The other side of the cross-charging scheme is this: on those jobs on which work was coming in under budget, such as the DD-997, the Navy was due the benefit of the underrun. In short, it was entitled not to pay for work not being done.

Corporate Policy and Corporate Practice

Ingalls' official corporate policy on timekeeping and cost accounting practices is clear: employees are responsible for keeping their own time logs, for filling out and signing their own time cards, and for ensuring that their time is charged as worked. This policy is set forth in the company's manual of regulations for employees, and it is emphasized in periodic newsletters from management as well as in memoranda from company officials concerning specific departmental infractions.

The penalty for falsifying company time records is discharge, according to stated company policy. Ingalls has reported that since 1977, 66 employees have been dismissed from the company for violating timekeeping procedures. Another 99 employees have been disciplined in some way short of discharge. However, most of those fired or disciplined had falsified their own time cards, or that of a friend or co-worker, for personal gain. Ingalls' officials have advised PSI that no employee has been fired for mischarging in order to meet budgets, as in the schemes described above. In fact, the three engineering supervisors recently disciplined by Ingalls for the oil rigs-to-Navy mischarging are among the individuals who carried out the much larger Navy-to-Navy scheme subsequently uncovered by PSI. Each claimed that he was unaware that it was against company policy to mischarge until he was discovered and disciplined by the company. Of the numerous Ingalls employees interviewed by PSI staff, not one knew of anyone within the company who had been dismissed for violating the timekeeping policy in order to meet company budget requirements.

The oil rig and CG-47 cross-charging schemes cannot be considered isolated instances. On at least seventeen occasions since 1977, either the Defense Contract Audit Agency or Ingalls' own auditors have brought similar situations to the attention of company management. Taken as a whole, these reports seem to amply demonstrate the fact that budget pressure had replaced stated company rules for many supervisors:

* "Employees charged to contracts without considering the contracts on which they actually worked." (March 25, 1982 Ingalls' internal audit report)

* "Direct labor is charged to contracts in accordance with a memorandum which designates individuals to charge to certain contracts for the months. This designation is made according to the available budget and not necessarily to storeroom assignment or the functions being performed. Time cards are completed by the supervisors/group leaders, and they are signed by the individuals..." (March 9, 1982 Ingalls' internal audit report)

* Charging according to budget cited in another cost center at Ingalls. (June 30, 1982 Ingalls' internal audit report)

Though the repeated instances do not necessarily reflect a mischarging scheme of the scope and duration of the situation discovered in the Piping Department, many are quite substantial. One audit found over 8,000 hours deliberately cross-charged on submarine overhauls. Other reports, consolidating three separate schemes, found a potential budget impact of $3 million in a single year.

In one instance, the internal auditors reacted to their June 1982 findings that time was mischarged according to a pre-planned schedule with seeming lack of concern:

> We have not discussed the conditions found with the Managers and Directors responsible for the cost centers not in compliance...To do so, we believe, would result in a multitude of reasons, obscure the actual conditions and reduce the desired impact.

There is no explanation as to what the "desired impact" might be, nor how it might be obtained. Regrettably, the evidence suggests that the impact desired is no impact which would impare budget performance. Rarely does an internal audit report indicate an auditor's question about why work is not charged as performed. On at least one occasion, however, Ingalls auditors, having described an extensive mischarging scheme they had uncovered, explicitly noted that:

> ... because of current budgetary practices, procedures and concepts, operating management must adhere to such practices as those described above. We do not question their sincerity or their desire to get the job done. We do not believe the conditions reported above are of their own making. (Ingalls internal audit no. S-81-27, March 9, 1981, p. 3).

Yet no disciplinary action against managers found to be in violation of official timekeeping policy has been recommended by the internal auditors. Likewise, no credit/debit remedies to contracts are even suggested.

Ingalls' Director of Internal Audits told a Subcommittee representative that he has no authority to initiate corrective action or follow up on his audit findings. Indeed, there is evidence that budget, and not official rules, was the guiding star even for the auditors themselves. Frequently, their reports note that, while conditions described "would normally result in recommendations for corrective action, reclassification... would create budget problems."

In light of this, it is not surprising that PSI, through the GAO, was informed by the Manager of Budget and Program Finance that no follow-up has been made to determine whether corrective actions recommended by DCAA are carried out by Ingalls as promised.

An apparent lack of prompt remedial action is in part a result of Ingalls' natural tendency to see each of these incidents as isolated and in its most favorable light. In a recent instance, in response to three of the latest mischarging schemes identified by PSI, company officials have been working with internal auditors to quantify and explain these situations. Many questions remain for Ingalls to answer, but the company's general reaction has been to acknowledge each incident and then to qualify its impact. The initial calculation of $20,000 later increased to $137,000 in the oil rig case described above is one example. Others are:

- Ingalls says that charging schedules issued by a department head to his material support group were intended as "guidelines" and were not, according to internal auditors, consistently followed in the charging of time, contrary to PSI's findings. Such a differing view is due, in part, to the fact that Ingalls reviewed records for a period beginning with the month after this practice had been discovered by DCAA. One of the section managers under the department head had told PSI that he was instructed to destroy his charging schedules immediately after Ingalls became aware of DCAA's discovery. Additionally, DCAA and Ingalls auditors have found identical charging schedules used for billing, not as "guidelines," in a number of locations throughout the shipyard.
- Once PSI discovered that manhours had been systematically mischarged between Navy cruiser and destroyer contracts, Ingalls acknowledged between 10,000 and 15,000 engineering manhours "may" have been misassigned. This estimate is conservative, based on the evidence at hand.

Throughout our investigation, Ingalls has remained steadfast in its view that the movement from one contract to another, particularly between Navy contracts, has little effect on cost data and performance measurements, a position absolutely inconsistent with current procurement theory. Indeed, under other circumstances the company has been emphatic about the importance of timekeeping, as in a June 1977 publication for its supervisors, entitled "Time Cards; A Daily Report on the Shipyard":

> ...We also use time cards to measure the efficiency of our production process.... How do we know that we are building LHA-3 more efficiently than we did LHA-1? The time cards tell us.... it is essential to tell us how efficiently we might build them in the future - so that we can realistically bid on new shipbuilding contracts....

The recurring incidents starkly illustrate the fact that it is another, unwritten rule which sometimes governs a worker's life at Ingalls and presumably at other such facilities. That rule has been succinctly summarized by Admiral Rickover:

> ...by focusing too strongly on so-called bottom line results, corporate officials can generate pressures that cause subordinates to act in ways they would not consider proper in their personal affairs. Under pressure to meet assigned corporate profit objectives, subordinates sometimes overstep the bounds of propriety - even the law. (Business and Society Review, Spring, 1981)

Punishment, as actually meted out, seems to reflect and reinforce the unwritten rules rather than official policy. As mentioned above, some of the same Piping Design personnel involved in the massive Navy-to-Navy cross-charging scheme described had eighteen months earlier admitted to the company their oil rigs-to-Navy cross-charging, amounting to several thousand dollars. Their punishment was a reduction in the raises they received.

A particularly disturbing aspect of the "dual policy" discovered by PSI involves "whistleblowers". Officially, employees are encouraged to report mischarging. In reality, PSI discovered that, while admitted mischargers continued on the job throughout the yard, at least three individuals who had reported mischarging were subsequently fired or harrassed into quitting. Other employees were found who had been troubled by the cross-charging they saw in the Piping Department but were afraid to come forward. Only after coaxing by PSI staff did one begin to unravel the scheme to company officials. He is still employed and the company has assured that he will remain so.

The intimidation of "whistle blowers", as our investigation showed, is not limited to those who report solely on budgetary matters.

Ingalls has consistently taken the position that mischarging is squarely in violation of its policies and it will protect "whistleblowers" jobs. Whether as a result of conflicting "unwritten" rules or not, those official policies appear so far to have failed.

The Defense Contract Audit Agency

The Defense Contract Audit Agency performs all contract audits for the Department of Defense, providing accounting and financial advisory services to all DoD procurement and contract administration components. DCAA's services are provided in connection with negotiation, administration, and settlement of prime and subcontracts.

At Ingalls, DCAA has day to day access to the contractor's books and records for the purpose of examining the accuracy of costs charged to the Navy. With its field office staff of auditors, DCAA periodically checks on Ingalls' compliance with federal cost accounting and timekeeping practices.

Our examination of DCAA materials showed that over 30 reports have been issued during the last seven years which cite timekeeping problems at Ingalls. Unannounced floorchecks by DCAA auditors have revealed that supervisors were making timekeeping entries on timecards for laborers, that employees have arbitrarily allocated their time to contracts regardless of actual work performed, and that managers distributed schedules in which employees' time had been planned and allocated for cost-charging purposes.

Most of the audits do not include DCAA's assessment of how much this mischarging costs the government. Several, however, did include projected losses ranging from $300,000 to $3 million. These estimates are based only on that mischarging which DCAA was able to document through its routine floorchecks of a few departments at the Shipyard. DCAA has not evaluated the broader implications of mischarging with respect to the integrity of the contractor's cost data, but several reports are explicit about DCAA's concern:

- "24.5% of the employees checked were mischarged, including arbitrary charging to hulls not actually worked....such charging to wrong contracts has potential annual cost of $573,000 just for employees caught in floor check." (Audit Report dated 2/24/77)
- As noted earlier, in 1981 that in two separate shops, Ingalls employees were mischarging work according to pre-planned schedules. DCAA said this is a "highly improper timekeeping practice" which "completely destroys credibility of any cost data generated." The contractor's response was a promise to put a stop to the practice of preplanned billing. However, in November 1982

> precisely the same practice was discovered again. DCAA, failing to cite the earlier "highly improper" finding, allowed the contractor to promise simply to stop the practice.

As strong as DCAA's remarks may appear, its recommended action to the Navy usually has little sting. For example, in a March 1980 audit in which it found departmental cross-charging with a potential annual impact of $3 million, DCAA's recommendation - in full - was that Ingalls should "reemphasize the importance of accurate timekeeping. All employees who perform timekeeping duties should be aware of the impact that timekeeping errors have on cost reporting and performance measurement." DCAA did not actually assess whether Ingalls cost reporting and performance measurement had been distorted by this cross-charging; Ingalls itself made no response to these audit findings.

In another audit, dated March 15, 1982, DCAA reported a 7% mischarge rate, which it deemed "insignificant" and not worth even discussing with the contractor. If a 7% error rate is deemed insignificant, however, it is cause for alarm, for if applied hypothetically to Ingalls' total government funded operations last year, it would amount to $53.6 million.

By charter, DCAA's role is limited to advising the Navy's contracting officer responsible for ship procurement who, in turn, channels DCAA's findings to Ingalls with the demand, if appropriate, that corrective action be taken. On several occasions DCAA audits were forwarded to Ingalls with a request from the Navy that corrective steps be taken to prevent further deficiencies in time charges. Ingalls regularly responds to the Navy with a note that it has taken, or will take, steps to direct employees on the importance of accurate timekeeping. That is the full extent of the company's uniform response. It is apparently all that is required by the Navy, for PSI was unable to find any instance of renewed Navy insistence on additional remedial steps.

DCAA is apparently satisfied as well, for it recently retreated from its own position and the strong language found over seven years' of audit reports. The agency's new position, contained in a letter to PSI dated March 29, 1983, is that mischarging at Ingalls is neither material nor pervasive. Furthermore, says DCAA, in light of PSI's investigation, it has gone back to an audit report of November 1982 in which a 58% error rate in charging was discovered at Ingalls' material support cost center where improper pre-planned charging memoranda were in use. The response of DCAA: "In this specific instance, the impact on Government contracts was not significant and there were no benefits to the contractor." That the data originally submitted by Ingalls was essentially arbitrary when modern procurement demands accuracy is not mentioned in this statement nor is the use of prohibited pre-planned charging.

DCAA's complacency is all the more troubling in view of how easily its auditors can be hoodwinked by Ingalls employees, as PSI discovered throughout our interviews. Witnesses described how a section manager, or his secretary, would warn floor workers in advance of DCAA checks. Others said an auditor will ask to which project an employee is assigned and then pick up his timecard several days later. Of course, by the end of the week the timecard matches the employee's statement. PSI found evidence of pre-arranged schemes where engineers kept two sets of drawings close at hand - one on which they worked and another "replacement" set to be visible during DCAA checks. Lastly, DCAA checked the

Ingalls Piping Design Shop in June 1981, which was during the massive cross-charging scheme we found there, and gave it a clean bill of health.

Perhaps the saddest - and most accurate - summary of the situation was provided by a twenty-year Ingalls manager interviewed by PSI: "DCAA? Who are they?"

Navy Procurement Attitude Emphasizes Production over Accountability

The ultimate responsibility for seeing that the taxpayers' money is effectively and honestly spent falls to the Navy. It is the Navy which is appropriated the funds, it is the Navy which strikes the bargain, it is the Navy which pays the contractor and it is the Navy which is accountable for oversight.

As noted elsewhere, there are other agencies which assist in the process, but the Navy bears fundamental responsibility for formulation of the contract and administration of its provisions. It must balance its desire to get its ships to sea with its obligation to ensure that American taxpayers are actually receiving a dollar's worth of defense for every dollar spent.

PSI's observations of Navy operations and attitude, however, from the Naval Sea Systems Command (NAVSEA) headquarters in Washington, D.C. to the office of the Supervisor of Shipbuilding (SUPSHIP) in Pascagoula, Mississippi, suggests that the balancing of Navy responsibilities is often unsuccessful. Cost effectiveness takes a back seat to the goal of getting the ships out.

Contract Administration

The Navy and Ingalls are veterans of the 1970's "total package procurement" concept which stressed fixed-price contracting with some escalation provisions for adjustment of the contract price. These contracts proved disastrous to the contractors, including Ingalls, which had seriously underbid the contracts. The results were large cost overruns as well as production delays, which the contractors attempted to recoup by filing claims based on the continued addition of new features to the ships of the Navy.

The Navy came under severe criticism, both internally (from Admiral Hyman Rickover) and externally (from the Congress) over its failure to control the mounting claims, which Admiral Rickover asserted were often based on fraud. Several of Ingalls' claims were settled in 1978 when the Navy granted more than $180 million in "extraordinary contractual relief" under the provisions of Public Law 85-804. This amount was in addition to the $312 million entitlement figure established by the Navy claims team handling the dispute. This brought additional criticism (see S. Res. 555 and S. Res. 556, 95th Cong., to disapprove the claims settlement under P.L. 85-804) and according to some Navy personnel PSI interviewed, reinforced the Navy's desire to avoid fixed price contracting.

Overruns and resultant claims can be avoided by use of a "cost-type" contract, in which estimates are made of project completion costs and adjustable ceiling prices are set. This contract form permits greater latitude in instituting changes because actual costs are paid as incurred, rather than being set as a total package price, which may be exceeded only by "overruns".

In developing a new class of warship, the Navy does need flexibility to modify its design to incorporate advancing technology and to work out engineering problems as the first ship is fabricated. Therefore, it is appropriate that the first ship of a new class be constructed on a flexible cost-type basis. However, once the problems are resolved in the initial ship construction, it is considered advantageous to complete follow-on ships of the class under fixed-price type contracts. Such was the Navy's conclusion in a study completed in July 1978, under the direction of then Assistant Secretary of the Navy Hidalgo. However, the subsequent follow-on ships of the CG-47 class have all been on a cost-type basis, specifically, "cost plus award fee".

Aegis Award Fees

Our most serious concern in examining the Aegis contracts at Ingalls centered on the award fee provisions - the Navy's determination of contractor profit. The contract specified that Ingalls could receive on a quarterly basis, as "profit", up to 15% of the contract costs. This would be divided as 3% "base fee" - guaranteed profit - with the remaining 12% as "award fee" for contract performance. Standards for performance and the method under which award fees are to be incorporated into a cost-type contract are stated in the Defense Acquisition Regulations (DAR), section 3-405. The purpose of the award fee is to encourage and reward superior performance by the contractor. According to the DAR, "The contract shall set forth those criteria to be used in evaluating the contractor's performance to arrive at the award fee."

The CG-47 contract contained the following provisions. The award fees were based on four elements: technical performance, cost performance, schedule performance, and management performance, and the determination as to Ingalls' success in meeting these elements were made by an Award Fee Panel headed by the Navy's Aegis Program Manager, Rear Admiral Wayne E. Meyer. The Panel met on a quarterly basis to determine the amount of the fee.

We reviewed the CG-47 contract to see what weighting had been assigned to each of the four evaluation categories, that is, what percentage of the award fee would be earned if the contractor was excellent in one category but marginal in a second? We found no weighting at all on the CG-47 contract. PSI was told by a Navy official that weighting was mistakenly left out of the contract. In discussions with other Navy contracting personnel, we were told that before the beginning of each quarterly evaluation period the Navy Program Manager himself or his representative verbally told the contractor what would be considered important at the next evaluation meeting. However, the Navy could not provide us with notes or other memoranda regarding these conversations. Nor could we find any evidence that such information was in fact used at the Award Panel meeting since the Navy told us it had not taken any notes or minutes of the Panel meetings and discussions. With respect to the CG-47, no written record exists as to the specific criteria upon which the Panel ultimately determined the award to the contractor.

The CG-47 awards were high - an average of approximately 85% of the available fee was awarded to Ingalls each time the Panel met. In many quarters, it was higher. Likewise, the Panel on the second contract for an Aegis cruiser at Ingalls, the CG-48, which also omits weighted criteria, has given Ingalls no less than 90% of the available fee for each of the first ten quarterly evaluations. Upon what basis awards were ultimately made cannot be determined because no record of the meetings exists.

One remarkable aspect of the CG-47 Award Fee Panel meetings conducted at Ingalls was the presence of the President of Ingalls Shipbuilding as a non-voting Panel member during the entire proceeding, including both presentation of the Navy's position and the actual vote on the fee to be awarded. Some procurement authorities suggest that his presence might prevent thorough debate over the contractor's performance. Certainly, his attendance at the meetings would inhibit the presentation of information obtained from company whistleblowers on improper company practices, for fear that the identity of the employee-informants would be exposed to the company.

Some participants in the CG-47 procurement process told us they felt that the reason Ingalls received such high fees was to keep the company "pumped up" with money so that schedule slippage would not occur due to lack of available funds, this approach of course required that more emphasis be placed on meeting schedules and getting the ships to fleet than on worrying about the cost.

An example of how this attitude translated into reality in the Navy's contract negotiation branch at Pascagoula was provided by a long-time Navy employee. He described the pressures put on Supervisor of Shipbuilding (SUPSHIP) Pascagoula personnel involved in pricing contract modifications. Specifically, in negotiating changes, the Navy negotiator has six months from receipt of the pricing package to finalize the cost. Ingalls representatives, however, are not under this deadline pressure and as a result, they often just "wait out" the Navy. After six months, the

Navy negotiator is "overage" on the negotiation and his bosses implore him to settle. Too many "overage" negotiations, he told us, lead to poor performance reports and loss of merit pay increases and promotions. Navy personnel told us of one former contracting chief who said, regarding disputes over prices with Ingalls, "Just pay the nice man." Another Navy officer with contracting responsibilities, we were told, repeatedly said, "The best price you are going to get is now." In one instance, a former Navy employee told us he became so frustrated with Ingalls' ability to "wait out" Navy negotiators, that he brought the matter to the attention of a Navy Captain who told him not to bother with such things because "If it's not worth $10 million, it's not worth ten minutes of my time."

Habitability

Purchases from certain discretionary funds have until recently not been subject to control by Navy contracting personnel. These include the purchase of replacement furniture, carpeting, wall coverings, lamps, and other accessory items for ships under construction at the Ingalls Shipyard. Called "habitability items", these "nice to have" but unnecessary purchases are funded through NAVSEA headquarters under monies allocated from the Shipbuilding and Conversion, Navy (SCN) appropriations.

Our review of Navy documents and interviews with numerous Navy personnel, both at Pascagoula and in Washington, revealed that while ships are in the final stage of construction and in sea trials, prior to joining the fleet, the assigned ship's Captain, or his representative, meets with interior design consultants from Litton Office Products of Pascagoula, who have been given a sole-source contract to provide the habitability items. There, the Captain's desires as to what changes he wants in the furnishings installed on the ship under the basic contract are made known. These changes run from reupholstering existing furniture - because the color doesn't fit the Captain's preferred motif - to completely replacing items with new designs. The interior design consultant drafts a proposal within the amount of funds allocated per ship, and the items are subsequently purchased, subject to the Captain's final approval. In many cases the items must be custom-made because the Captain has requested a special material or because of space restrictions which preclude showroom furniture purchases. Further, safety requirements mandate a certain level of fire retardancy and other features that must be incorporated into the design. As in the contract as a whole, primary emphasis frequently appears to be on providing the desired items in the required time frame, with cost being given little, if any, consideration. We found, for example, that a sectional sofa purchased for the U.S.S. Callaghan (DDG-994) cost $14,000. A custom made bookcase with planter for the same ship cost $13,500, while elsewhere on the ship, an "elephant sculpture lamp" was purchased and installed for $319. On the U.S.S. Kidd (DDG-993), carpeting with a base cost of $58 per square yard escalated to $93.00 per square yard because of such additional charges as "three research trips to New Orleans, Louisiana" and "one research trip to Dallas, Texas to find suitable carpet." Other add-ons to the cost of the carpet were a "transporation fee to guarantee delivery", "Consultation by Manufacturer to ensure timely delivery," and "Administrative costs above usual and normal cost" amounting to $600. Those unusual costs were not explained. Other items purchased for various ships included a custom-made brass and plexiglass telephone stand ($930), a custom-made lounge chair ($1,535), and a brass and plexiglass coffee table (1,000).

Since most of the furniture purchased was to replace new items installed by Ingalls but unacceptable to the Captain, we asked what disposition was made of the replaced items. Navy officials at Pascagoula said that those furnishings were either relocated on the ship or sent to a storage facility at the Shipyard where they are available for use on subsequent ships. They did not know if any of the items stored had in fact been requested for use on later ships. We found no evidence that they had.

Navy contracting personnel stationed at Pascagoula told us that they have little control over habitability expenditures. Their opinion is that the amount of money spent is set by Washington and that as long as the spending limitation is not exceeded, there is no authority to evaluate the ship Captain's judgement on how the money is spent. Navy contracting supervisors told us that while they recognized the problem with spending funds for such "luxury" items, they are hard pressed to put a stop to it. They did attempt to control some of the purchases by requiring that all contacts with Litton Office Products representatives be made through the contracting office, but they were candid in admitting that it was very difficult to tell a Navy Captain he could not have something on his ship for which he had been given money. An undated memo by the shipbuilding contracting branch recommended that the entire Naval Sea Systems Command "should standardize the furnishing to be provided on the ships and adequate time be allotted for providing the same to enhance the possibility of competition in the market place." That memo is submitted for the record. Neither of these suggestions was adopted. Recently, following our review, in a March 24, 1983 instruction, the Navy set policy on the use of "habitability funds" by restricting the use of such funds so that furniture items installed by the contractor cannot be removed or replaced "solely to achieve a more esthetically pleasing arrangement." Unaddressed, however, is the manner in which cost limitations are to be determined.

The Justice Department

However effective or ineffective the various "watchdog" groups may be, the taxpayers' ultimate guardian is the Department of Justice. With both civil and criminal jurisdiction, DOJ has the means to detect and deter all manner of improper conduct by a defense contractor and its employees that is directed at the government.

Merely having the means seems to be no guarantee of success, however. The Department's record in connection with fraud-type cases against Ingalls is one of extremely limited success. While able to make an occasional criminal case against an individual employee for theft or a similar offense, DOJ's effort to build a successful prosecution on the basis of systematic mischarging or fraudulent claims has been limited to two cases in the last six years. One was dismissed for the Department's failure to proceed; the second was settled on the basis of information developed not by DOJ, but by this Subcommittee.

The first case, United States v. Litton Systems, Inc. d/b/a Ingalls Nuclear Shipbuilding Division (Cr. No. 5-78-0031-R, S.D. Miss.), charged Ingalls with submitting false documentation in support of its claims for additional payment on certain submarine contracts. The indictment which involved $37 million alleged fraud, was handed down in April, 1977; it was dismissed on March 2, 1983, following a forty-two month period in which the Department, in the dismissing

Judge's words, "...took no action whatsoever". It was this delay of almost four full years upon which the Judge based his dismissal, terming the delay "...conscious, intentional...(and) deliberate". DOJ's case was not improved by its having lost several boxes of critical documents during the four years it sat on the case. A copy of the Judge's full opinion is submitted as an exhibit.

The only other judicial proceeding brought against Ingalls involving DOJ and Ingalls was not in fact initiated by the Department. Rather, it was originally filed by a private citizen, formerly employed at the Ingalls Shipyard, where he had seen oil rig work charged to Navy contracts. On that ground, he brought a civil suit in August 1981, under the False Claims Act, 31 U.S.C. §231 et. seq. DOJ stepped in after the case was filed, as the statute allows. Ingalls answered the complaint, admitting to "erroneous charges" not in excess of $20,000. There the matter sat for approximately eighteen months until PSI staff entered the picture in early February, 1983. Armed with the very same information DOJ had obtained a year and a half earlier, PSI staff in three days established, primarily through participants' admissions, a cross-charging scheme many times greater than the $20,000 originally admitted by Ingalls. Two months later, on April 7, Ingalls and DOJ entered into a settlement agreement described earlier, which required Ingalls to return to the Navy a total of $137,000 in cash and contract credits.

Effective investigation and prosecution in Pascagoula may be hampered by the habit of Justice Department representatives as well as Naval investigators to regularly work side-by-side with Ingalls security employees in conducting investigations. One Ingalls employee interviewed in the course of PSI's investigation stated that he had once been interviewed by "either Ingalls security or the FBI. What's the difference?" Another said with conviction, "Ingalls is bigger than the FBI".

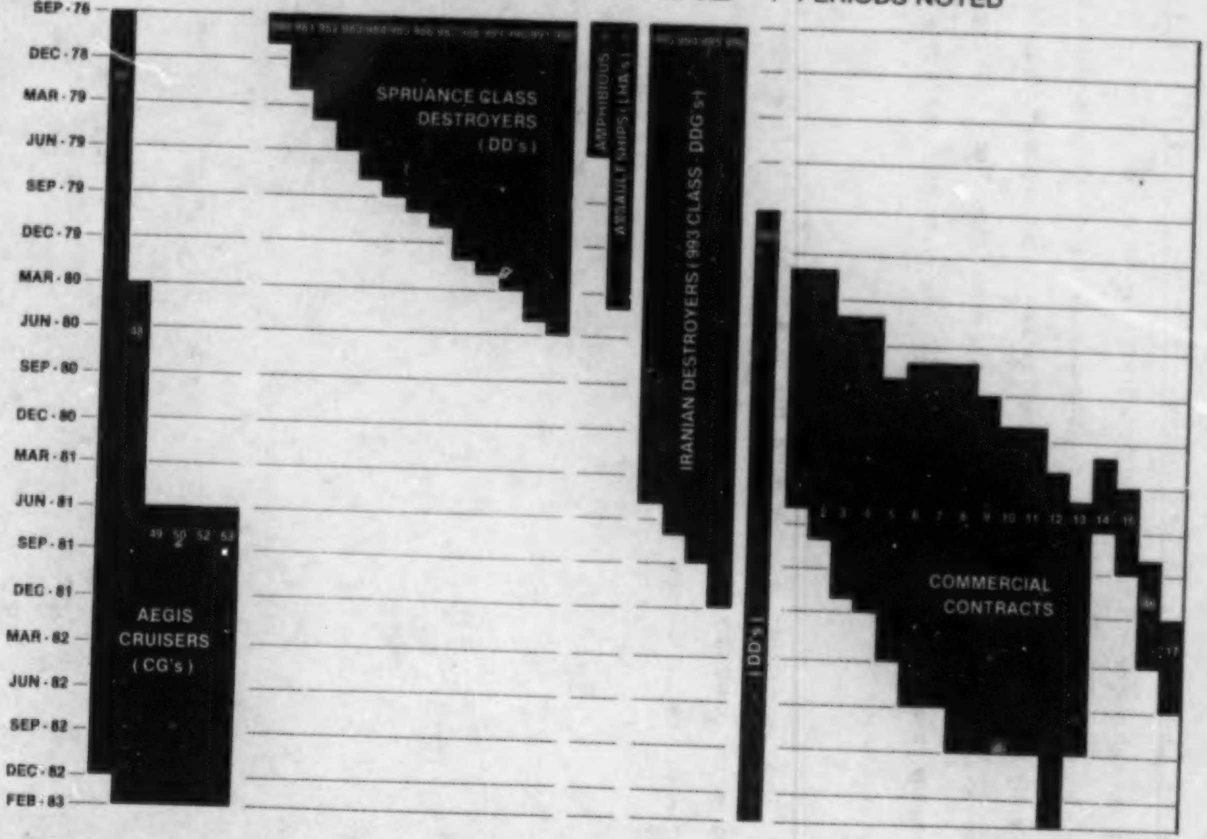
This is a point made repeatedly and persuasively by Admiral Hyman Rickover in recent years. Interviewed by PSI staff in the course of its investigation, the Admiral, drawing on evidence he had gathered over years of involvement with Navy procurement, charged that the Department regularly "scuttles" cases against major defense contractors. He told PSI that devotes grossly inadequate resources to such cases and assigns them to inexperienced attorneys and investigators, who are frequently reassigned before they can master the case.

The Navy's law enforcement branch, the Naval Investigative Service (NIS), also works to gather evidence of criminal activity at the Ingalls Shipyard. Most of NIS's work there over the past years involved sleuthing for lost Navy equipment such as typewriter power packs and "signal conditioners" from Navy ships and Ingalls storerooms, as well as unauthorized purchases by the contractor of model ships. While some investigations did touch on alleged contractor improprieties, we could find no meaningful investigative effort devoted to the development of procurement fraud cases. In fact, the one NIS agent assigned to watch over the huge Navy interests at Pascagoula told us that he does not try to develop a network of informants within Ingalls because the company is very powerful and could forbid him from entering company property if it found out what he was doing. He also said he had other investigative responsibilities which kept him from concentrating much of his time on any one thing.

As noted, our investigation disclosed that Ingalls Shipyard security personnel conduct joint investigations and interviews with NIS on cases which put the company at risk or in which the company itself may be a prime suspect. In one case involving serious allegations of time-charging fraud by Ingalls, made by a recently-fired Ingalls employee, NIS's investigation was a two-page synopsis of the charge, which the Navy turned over to Ingalls to investigate. Not surprisingly, the company gave itself a clean bill of health. NIS's only effort here was to interview the informant at which time he re-stated his allegations.

This environment, together with the unhappy history of "whistleblowers," makes the possibility of developing an effective intelligence and prosecutorial effort with regard to systematic fraud highly remote.

INGALLS SHIPYARD | WORKLOAD FOR PERIODS NOTED



08/28/81

TIME CHARGING effective Monday, August 31, 1981 the following charging will be maintained for the accounting month of September, 1981.

INDIRECT:	H. A. Maples			
	B. A. McDonald			
OG 48:	R. H McCravey			P422 0607 0001
	R. A. Cagle			
DD 997:	D. P. Russell			P418 0602 0003
	N. C. Franklin			
	J. E. Biggs			
	M. E. Cunningham			
	C. A. Reeves			
COMMERCIAL:	R. H. Naquin	- GLOBAL		P638 0681 0002
	L. L. Turner	- GLOBAL		
	M. Scott	- GLOBAL		
	E. W. Reed	- KEYES		P624 0681 0010
	E. E. Sharp	- KEYES		
	C. L. Richards	- CHILES		P635 0681 0002
	B. R. Butterfield	- BONITO		P639 0681 0002
	V. M. Little	- BONITO		
	B. K. Clark	- T/W 72 & 73		P636 0680 0009
	J. M. Marion	- T/W 72 & 73		
	C. P. Naquin	- T/W 72 & 73 HUTHNANCE	20 hours 20 hours	
	J. R. Eriksen	- T/W 69 & 70 HUTHNANCE P631 0681 0012	20 hours 20 hours	P620 0680 0101

OVERTIME requests must be approved in advance and written justification of the support rendered must be submitted to my office by no later than 10:00 A.M. the Monday following the week-end support. Regular daily overtime support will be submitted in writing the following morning.

Time charging will be monitored and any changes will be directed by this office.

B. A. Hart
B. A. Hart

INGALLS
Shipbuilding
Litton

P. O. Box 149 Pascagoula Mississippi 39567 601-935-1122

PERM. SUBCOMMITTEE
RECEIVED
FEB 24 1983
ON INVESTIGATIONS

February 23, 1983

S. Cass Weiland, Chief Counsel
United States Senate
Committee on Governmental Affairs
Senate Permanent Subcommittee on Investigations
101 Russell Senate Office Building
Washington, D. C.

Dear Mr. Weiland:

In your letter of February 10, 1983, you enumerated several items of information which you asked us to submit. Item 3 of that list involves the submittal of documents pertaining to "Ingalls' collected record of time charging investigations and internal disciplinary proceedings." Karen Hainer also expressed interest in receiving copies of all company policies and procedures relating to time charging and information on the efforts of the company over the past few years to communicate to its employees the company's policies. The purpose of this letter is to respond to these requests.

A firm policy is followed by the company in dealing with time charging violations. Our company rules regarding falsification of company records (including time charging) have been in effect for many years. They have been widely and continually publicized to all employees and repeatedly emphasized to all supervisory personnel. As the statistics will bear out in the information that is attached, we have consistently taken disciplinary action, including discharge, against those individuals who have been found to falsify time charging records.

The company policies and procedures regarding falsification of records are based on sound legal and practical reasons, and have been applied in a reasonable and uniform manner over the years. The information which follows will provide you with the following:

I. Background - Essentiality of Time Charging Accuracy

II. Ingalls Policies and Procedures on Time Charging

III. Ingalls Audits of Compliance with Policy and Procedures

IV. Dissemination of Information to Employees on Time Charging

V. Disciplinary Action Taken for Time Charging Violations

After your review of the enclosed material, please advise if there is additional information on these subjects which you desire.

Very truly yours,

INGALLS SHIPBUILDING DIVISION
LITTON SYSTEMS, INC.

George W. Howell
George W. Howell
Vice President &
General Counsel

GWH:NOB

Enclosures

cc: Rodney Smith, Esq.

I.

BACKGROUND - ESSENTIALITY OF TIME CHARGING ACCURACY

Ingalls Shipbuilding Division has an integrated Management Information and Control System (MICS) which is used to meet the internal management requirements and which fulfills the requirements of Ingalls' contracts with the U. S. Navy that we comply with Department of Defense Instruction 7000.2, Performance Measurement for Selected Acquisitions. Specifically, the MICS system: (1) integrates ISD planning, scheduling, budgeting, work authorization, cost accumulation and estimating elements with both the customer's work breakdown structure and Ingalls' organizational structure; (2) provides valid, auditable and timely performance reports from common data bases in order to satisfy both Ingalls management and Navy requirements; and (3) permits positive identification of cost and schedule variances by relating actual cost and schedule performance to preestablished time-phased budgets, schedules, organizations and work stations.

A key element of this management system is accurate time charging. Recording actual hours worked to the proper contract, hull, work station, etc., is required:

(1) To maintain the integrity of our company in its dealings with its customers

(2) To provide accurate information for managing and cost control

(3) To provide an accurate base for estimating new contract work, since Ingalls uses historical cost performance as the basis for estimating.

Ingalls has issued policies and procedures which clearly enunciate our policy of accurate, complete time charging, the procedures for implementing this policy and the penalties for failure to properly follow these procedures.

II.

INGALLS POLICIES AND PROCEDURES ON TIME CHARGING

Attached herewith as Exhibit One are copies of the current Policies and Standard Procedures that deal with time charging. The Policies are:

Policy 3090.00, Rev. C, Time Card Certification and Approval, effective February 17, 1976 (Note Section E)

Policy 5030.01, Rev. A, Control of Employee Applied Time, effective March 16, 1976 (Note Section C)

Policy 1020.10, Rev. C, Certification of Records, effective Nov. 27, 1979 (Note Section B, last sentence)

Policy 3090.00, Rev. D, Preparation and Approval of of Employee Time Cards, effective October 29, 1976, supersedes 3090.00, Rev. C (Note Section E)

The procedures are:

3090.10, Employee Time Cards, Preparation of, effective October 16, 1979 (Note paragraph 6.4)

3090.11, Time and Labor Charging Record (Direct Exempt Employees), effective March 13, 1982

In addition to the Standard Procedures applying to time charging, I am also attaching the Standard Procedure 5060.09, "Exempt Employee Disciplinary Action," which applies to disciplinary action for exempt employees. (The initial procedure dealing with disciplinary action was issued in 1974). Section 5.2 deals with records falsifications. As can be seen from these documents, Ingalls has had long-standing firm policies and procedures regarding accuracy of time charging and disciplinary action related thereto.

III.

INGALLS AUDITS FOR COMPLIANCE WITH POLICY AND PROCEDURE

Ingalls has an internal audit group, one of whose functions is to audit the compliance of Ingalls' employees with our time charging policies and procedures. Since July 1976 Ingalls' Internal Audit has conducted 29 audits of time charging. In addition, there are routine checks of time charging through normal supervisory channels and through our cost control system.

In addition to Ingalls' own actions in this area, the Defense Contract Audit Agency during this same time period, has issued 34 Audit Reports on time charging to the U. S. Navy with copies to Ingalls. Ingalls takes action on these DCAA audit reports.

IV.

DISSEMINATION OF INFORMATION TO EMPLOYEES ON TIME CHARGING

To further emphasize the importance of proper time charging, Ingalls reminds its employees of proper time charging procedures from their date of accession to their leaving the company.

At the outset of an employee's hire with Ingalls, they are provided with information during their orientation that addresses the subject of time charging and record falsification. Exhibit Two provides you with the following documentation.

Copy of information from the company's Manual of Rules and Regulations which is distributed to all new employees (Note Section X.)

Orientation Check List for hourly employees which the supervisor completes when a new hire is sent onto a job. (Note bracketed sections)

During the course of the employee's tenure with the company, they are continually reminded of the need to assure that they are properly charging their time. In addition to signs that are near the time clocks that warn against time card violations, articles frequently appear in the company in-house news publication. Exhibit Three deals with information concerning time charging which has been disseminated through the company newspaper. In addition to articles appearing in the Ingalls News, the Ingalls Management Association has for several years published a Management Newsletter. A copy of this Management Newsletter also appears as a part of the documentation in Exhibit Three.

Frequently, company bulletins and correspondence from company officials deals with the subject of proper time charging. Exhibit Four is a collection of miscellaneous documents all pertaining to the subject of time charging and re-emphasizing the importance of correct charging information as follows:

Bulletin, F. J. Frederic, Jr., Controller, dated 6/28/78, Proper Charging of Employee Time

Bulletin, L. J. Corti, Director Finance, dated 8/16/76, SP 3090.10, Employee Time Cards

Correspondence, W. A. Roemer, Manager Operations Administration, dated 5/9/79, Time and Labor Charging

Correspondence, R. E. Ryan, Assistant Vice President Operations, dated 7/5/77, Labor Rejects

Correspondence, R. E. Ryan, Assistant Vice President Operations, dated 5/14/77, Work Transfer

Correspondence, E. F. St. Amant, Jr., Section Manager Payroll, dated 2/23/78, Exempt Time Card Preparation

Bulletin, F. J. Frederic, Jr., Controller, dated 4/29/76, SP 3090.10 Employee Time Cards

Bulletin, E. W. Prince, Controller, dated 9/14/72, Time Cards

Correspondence, L. J. Corti, Director Finance, dated 8/18/76, Time Charging

Correspondence, L. J. Corti, Director Finance, dated 8/25/76, Timekeeping

In 1977, Mr. Leonard Erb, President Ingalls Shipbuilding Division, addressed all supervisory employees in a series of meetings designed to provide an up-to-date status of Ingalls' business practices. One of the subjects that was discussed was proper charging of time. Exhibit Five is an extract from the outline used in Mr. Erb's address.

V.

DISCIPLINARY ACTION FOR TIME CHARGING VIOLATIONS

While discharge has been a frequent end result of investigations involving infractions to the labor charging rules, it has not been the exclusive disciplinary remedy. The company reviews the investigative facts and takes the remedial action which it feels to be the most appropriate for the falsification situation. Depending on the circumstances, disciplinary action will vary and discharge, as well as other forms of admonishment, are action options available to the company.

Over the past six years (since 1977), the company has imposed formal disciplinary action against 165 employees for violation of time charging policies and rules. These actions include the discharge of 66 employees during this period.

Report - Providing Furnishings for Wardrooms, Staterooms, etc for USS Fletcher and DD993, DD994 and DD995

This survey was undertaken because of the apparent extravagance demonstrated in furnishing certain areas of these ships for habitability purposes. Points of contact for this effort were Mr. Roger Banks of Ingalls and Mrs. Sue Wright of Litton Office Products.

The basis for these so-called "habitability" changes appears to be the fact that the standard furnishings provided for the specified area lack the aesthetic appeal required to satisfy the occupants of the areas. The only solution appears to be action taken by NAVSEA to establish standards for furnishings and adhere strictly to the standards.

The usual sequence of events, as related by Mrs. Wright, appears to be as follows:

> A meeting is arranged by ISD with the ship's Captain and Litton Office Products (Mrs. Wright) to discuss furnishing for the specified areas. At this time the amount of money available for the job is revealed. Further discussions ensue in which the Captain indicates what his desires are and Litton then proceeds to provide estimates, samples and suggestions on how to obtain what is desired and remain within the budget limitations. Each item is subject to the approval of the ship's Captain. In many instances the furnishings must be custom made, such as brass coffee tables and custom made couches with metal frames, fire-retardant padding and leather upholstery. To meet ship safety requirements special anchors have to be attached to fasten furnishings to the deck. All these items are made from the highest quality materials and manufactured to exact specifications by experienced craftsmen. Ships are in the yard only during restricted availability and due to the extremely limited time available for the purchase/manufacture and installation of these furnishings, no attempt at obtaining competitive bids or quotes is made. Litton Office Systems relies upon their experience in this area to obtain the best service possible under the circumstances, with primary emphasis placed on providing the items desired in the required time frame, with cost being a secondary factor.

Examination of the Bills of Material/Service for the Fletcher, Kidd, Callaghan and Scott indicate that the items charged to the ship were supported by actual invoices and/or purchase orders. No irregularities were detected in any of these areas. Some actual costs when compared to the amounts charged were high and some low such as the cost of sofa and chairs was shown to be $19,672.12 while the amount charged was $18,000.00. Others appeared reversed, i.e., the amount charged was higher than the actual cost.

According to Mrs. Sue Wright, they operate on a basis of approximately 29% gross profit. Gross profit would include all G&A and overhead costs plus a net profit in the 7%± range. National trade magazine supported the following gross profit ranges:

Geyers: 36%
National Home Furnishings:
  Chain groups: 43.7%
  Individual Stores: 41.7%
National Office Products:
  Office furnishings: 39%
  Other furnishings: 29%

Based on the information obtained, the following conclusions are reached and recommendations made:

Litton Office Products is providing the services required at a cost commensurate with value received.

It is recommended that, in the interest of economy, NAVSEA should standardize the furnishings to be provided the ships and adequate time be allotted for providing the same to enhance the possibility of competition in the market place. As a further step all furnishings could be made GFE or GFP.

The Bills of Material/Services for the USS Fletcher, Kidd, Callaghan and Scott are provided as attachments to this report.

Donald S. Slider

DONALD S. SLIDER
Contract Specialist

SOUTHERN DISTRICT OF MISSISSIPPI
FILED
MAR 2 1983
CLARENCE A. PIERCE, CLERK
BY__________ DEPUTY

RECEIVED
MAR 1983
LEGAL DIVISION

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF MISSISSIPPI
SOUTHERN DIVISION

UNITED STATES OF AMERICA

VS. CRIMINAL NO. S78-0031(R)

LITTON SYSTEMS, INC.,d/b/a
INGALLS NUCLEAR SHIPBUILDING
DIVISION

REASONS FOR JUDGMENT

Litton Systems, Inc. (Litton), indicted in April of 1977 for allegedly making a false claim against the United States government (18 U.S.C. §287)[1], has filed a motion to dismiss the indictment because of "inexcusable and prejudicial prosecutorial delay" and the "loss and destruction of exculpatory evidence." Litton contends that, considering the delay and resulting prejudice, further prosecution would violate its Sixth Amendment right to a speedy trial. Litton also urges dismissal on the basis of Rule 48(b) of the Federal Rules of Criminal Procedure.[2] For the following reasons, the motion to dismiss the indictment was granted.

In 1968, the Ingalls Nuclear Shipbuilding Division of Litton entered into a contract with the United States Navy for the construction of three nuclear submarines. Prior to the awarding of the contract to defendant, the Navy conducted an investigation to determine the manpower and facilities capability of the Ingalls Shipyard; the documents accumulated in this investigation are referred to as "source selection documents."

Over two years after the contract date, Litton filed a claim with the Navy, seeking compensation for increased contract costs which Litton asserted were made necessary by actions of the government. After this claim was made by Litton, the Navy conducted another investigation, this time gathering "production audit documents" which defendant had relied on in making its request for increased compensation., The claim was brought before the Armed Services Board of Contract Appeals (ASBCA), and in early 1976, after hearing sixty-nine days of testimony, the board awarded Litton over sixteen million dollars.

Before the ASBCA ruling was handed down, the government began a criminal investigation into allegations of fraud relating to the claim made by Litton. Evidence was presented to three grand juries, one of which expired after 18 months of investigating only Ingalls Shipyard without returning an indictment. For six days in April of 1977, a fourth grand jury heard a summary by two FBI agents of the evidence before the prior grand juries and returned a one-count indictment against the corporate defendant only. All of these grand juries were empanelled in the Eastern District of Virginia.

Shortly after the indictment was handed down, the United States District Court granted a motion to dismiss the indictment on the ground of prosecutorial misconduct during the grand jury proceedings. Early in 1978, the United States Court of Appeals for the Fourth Circuit reversed and remanded the case for trial. 573 F.2d 195. Later that year, the district judge granted a defense motion for change of venue and transferred the case to the Southern District of Mississippi, where the Ingalls Shipyard is located.

A status conference was held on January 25, 1979; the parties jointly agreed that the case need not be set for trial within the 60 day period[3] provided in the Speedy Trial Act (18 U.S.C. § 3161(c)(1) and (e)). An order issued after the conference allowed the parties forty days to file motions, and stated that if a party objected to a motion being heard, on the basis that the motion had already been decided by the district court in the Eastern District of Virginia, then a hearing was to be set on the "objection" prior to any substantive action on the motion itself. By March 19, 1979, Litton had filed several motions, and the government had filed objections, seeking the dismissal of all but one of the motions. A hearing on the objections was never set by the government; in fact, the government did not take any further action toward prosecution for over three and one-half years, until September 22, 1982, when the government filed a motion to set a trial date.

During the intervening period, the only activity which could be construed as in furtherance of the prosecution was a meeting on December 17, 1979, provoked by defendant's attorney, to discuss possible settlement. The settlement negotiations were short-lived; on January 23, 1980, Litton's attorney wrote to the U.S. Attorney, confirming that negotiations were ended. The letter stated that "[i]t is understood that the parties' agreement not to take any further actions concerning the criminal case during the pendency of settlement negotiations is terminated."

I. SPEEDY TRIAL UNDER THE SIXTH AMENDMENT

The starting point for any analysis of an alleged violation of the Sixth Amendment right to a speedy trial is the United States Supreme Court decision of *Barker v. Wingo*, 407 U.S. 514 (1972). *Barker* sets forth a four-part "balancing test" to be applied on an *ad hoc* basis whenever an issue concerning a breach of the speedy trial guarantee is raised. *Id*. at 530. The United States Court of Appeals for the Fifth Circuit recently discussed the *Barker* test and its factors as follows:

> *Barker v. Wingo* provides the tetrad standard against which we must measure the elusive speedy trial perquisite: (1) duration; (2) reason for the delay; (3) defendant's assertion of the right; and (4) prejudice caused by the delay. No one consideration is "either a necessary or sufficient condition to the finding of a deprivation of the right of speedy trial . . . they are related factors and must be considered together with such other circumstances as may be relevant." 407 U.S. at 533, 92 S.Ct. at 2193.

United States v. Greer, 655 F.2d 51, 52 (5th Cir. 1981). See also Jamerson v. Estelle, 666 F.2d 241 (5th Cir. 1982); United States v. Herman, 576 F.2d 1139 (5th Cir. 1978); United States v. Edwards, 577 F.2d 883 (5th Cir. 1977), cert. denied, 439 U.S. 968 (1978); United States v. Avalos, 541 F.2d 1100 (5th Cir. 1976); Arrant v. Wainwright, 468 F.2d 677 (5th Cir. 1972).

Considering these four related factors together with the other circumstances relevant to this prosecution, we conclude that Litton's right to a speedy trial has been violated and that the indictment should be dismissed.

(A) Length of Delay

The Sixth Amendment right to a speedy trial attaches at the date of arrest or, in this case, indictment, and runs until the commencement of trial. United States v. Gonzalez, 671 F.2d 441, 444 (5th Cir. 1982). Because the government could not proceed to trial until the case was transferred to Mississippi, we consider the delay period as commencing then rather than at indictment. The transfer to this district was in late 1978; the government first filed a motion to set a trial date on September 22, 1982, over three and one-half years later. The government argues, and correctly so, that the length of delay sufficient to warrant inquiry into the remaining Barker factors is related to the complexity of the case; however, forty-five months is an extraordinary delay by any standard. This conclusion is mandated by the Fifth Circuit's determination in United States v. Avalos, supra, that a 15 month delay in a complex conspiracy case "triggered" the Barker test. Moreover, the government had spent years prior to indictment compiling evidence against Litton; by the date of indictment it should have been prepared to proceed to trial promptly.

(B) Reasons for Delay

We now consider the government's asserted justifications, or lack thereof, for the lengthy delay. Three general categories of reasons for delay have been suggested by the Fifth Circuit, each assigned a different weight of culpability: deliberate delay, negligent delay and justified delay. United States v. Avalos, supra; Turner v. Estelle, 515 F.2d 853 (5th Cir. 1975), cert. denied, 424 U.S. 955 (1976).

We classify the period between indictment and March 19, 1979, as justified delay. It was during that interval that defendant's motion to dismiss the indictment for prosecutorial misconduct before the grand jury was granted by the district court, the district court's decision was reversed by the Court of Appeals, and the case was remanded to the district court in Virginia and then transferred to this district in Mississippi. The date March 19, 1979, is significant because it was at that point that all motions and objections thereto had been filed. It was then the government's obligation to take steps to bring the case to trial.[4] Although this period can be justified, the government, cognizant of the amount of time that already passed in this "justified period", should have moved all the more expeditiously thereafter. Both lengthy prior periods, the first between the alleged criminal activity and indictment, and the second between indictment and March 19, 1979, amplify the unreasonableness of any subsequent periods of unjustified delay.

From March 19, 1979, until 42 months later, September 22, 1982, when the motion to set a trial date was filed, the government took no action whatsoever. The court's other commitments would, of necessity, require several additional months of delay between the motion to set a trial date and the commencement of trial, especially considering the anticipated length of trial.[5] Thus the period of prosecutive inaction is more appropriately estimated at four years. As noted earlier, the constitutional right to a speedy trial attaches at indictment and runs until trial, not merely until the date on which the government moves to set a trial date. United States v. Gonzalez, supra.

The government has offered various explanations for several segments of this four year period. It would serve no useful purpose to discuss all of these in detail, but some discussion is necessary to demonstrate that the government has merely explained, but not justified, the long delay.

The government's primary explanations for the delay relate to internal problems within the Department of Justice. In particular, an attorney whom the government considered to be an essential part of its trial team had gone into private practice in 1978 and had difficulty in arranging his schedule to take part in the Litton litigation. A related "problem" was that serious discussions were being carried on within the Department of Justice as to whether or not the prosecution of Litton should be pursued. Such explanations of course do not justify the deprivation of the right to speedy trial, especially since Litton was unaware of the government's "problems." As far as Litton knew, or any other reasonable defendant would have believed, the case had been abandoned by the United States. Certainly the record supports the conclusion that the government had abandoned the prosecution and decided to resurrect it shortly before the motion to set a trial date.[6]

The court's impression that the government's explanations were not excuses nor "justified reasons for delay" was confirmed at oral argument by the government's admission that in fact no action was taken because the prosecution was satisfied with the status quo and with not proceeding to trial.[7]

Additionally, while under certain circumstances complexity may justify a longer than normal delay, the government nowhere suggests that the reason for the delay is the complexity of this case. Admittedly, the government's desire to have a former government attorney return from private practice to try the case is related to its complexity. However, the Justice Department never requested that attorney to rearrange his commitments in private practice to accomodate to a speedy trial of Litton. At any rate, as already noted, the government admitted that the true reason for the delay was that it was "perfectly satisfied with the fact that nothing was moving forward." That the long delay was deliberate can be determined entirely from the following colloquy during oral argument, between the government's special prosecutor and the court:

> THE COURT: Well, you just got finished telling me ... that all the Government had to do was ask you and you would have been "Johnny on the spot".
>
> MR. DUNHAM: I said that I would have attempted - I just told you, Your Honor, I said I would have attempted to organize my schedule in such a way that I could have accommodated them.
>
> THE COURT: I understand that.
>
> MR. DUNHAM: And I believe I made myself clear, Your Honor, that it is not something that I had complete control over. I had Judges in the District of Columbia and Eastern District of Virginia to deal with --
>
> THE COURT: Nobody suggested that you had that. What I'm saying is that no attempt ever was made to mesh those schedules, and you have told me that, and I understand that. The Government never asked you to accommodate to an earlier trial date in this matter.
>
> MR. DUNHAM: That's true Your Honor.
>
> THE COURT: It sat still and said we're satisfied the way things are going.

MR. DUNHAM: That's exactly - Now that's --

THE COURT: That's it.

MR. DUNHAM: I don't quibble with that at all, Your Honor. That's correct.

THE COURT: Now the problem is, you know, how does that implicate the Defendant's rights under the constitution.

A final justification offered by the government for the four year delay is that during that period the government and Litton entered into settlement negotiations, and apparently struck an understanding that the criminal prosecution would not move forward during the ongoing discussions. Review of the record shows that the government is correct, that discussions did occur at the request of the defendant for exactly five weeks[8] of the four year period. The parties met on December 17, 1979, agreeing that prosecution would be stayed during negotiations; the talks broke off on January 23, 1980. On that date a Litton attorney notified the government by letter that their understanding concerning a stay of the criminal prosecution was terminated. Because the settlement negotiations involve only an insignificant part of a substantial period of delay, the unjustified nature of the total delay is unaffected. Even if the negotiations had occurred over a longer period, the time spent in settlement discussions should weigh against the government. Settlement negotiations can be analogized to the process of plea bargaining, the period for which has been held to weigh against the government. "[I]f the government wishes to bargain..., it may but it should do so mindful of the risks which it thereby assumes of dismissed indictments for unconstitutional delay." United States v. Carini, 562 F.2d 144, 149 (2d Cir. 1977).

See also United States v. Roberts, 515 F.2d 642 (2d Cir. 1975).

Clearly, the reasons for the delay are not "justified"; indeed, we categorize the delay as "deliberate", not merely "negligent." Turner v. Estelle, supra; United States v. Avalos, supra. Neat categorizations of previous decisions do not apply to the present extraordinary situation in which the government admits that an excessive period of inaction was the result of governmental complacency. Surely such a conscious, intentional decision not to proceed presents more than a negligent or neutral reason for delay. The decision not to seek a trial date for nearly four years was deliberate[9], and, thus, weighs very heavily against the government.

(C) Assertion of the Speedy Trial Right

Not surprisingly, the Supreme Court in Barker v. Wingo, supra, at 527, placed the responsibility for bringing a criminal prosecution to trial squarely upon the shoulders of the prosecution:

> A defendant has no duty to bring himself to trial; the State has that duty as well as the duty of insuring that the trial is consistent with due process. Moreover, for the reasons earlier expressed, society has a particular interest in bringing swift prosecutions, and society's representatives are the ones who should protect that interest.

Although rarely will a defendant be anxious to have himself brought to trial, the Court nevertheless concluded that a consideration to be weighed along with the other factors was whether defendant had asserted the speedy trial right.

Under the unsual circumstances of this case, Litton's conduct was sufficient to constitute its assertion of its Sixth Amendment speedy trial right. If nothing else, the letter to the prosecutor dated January

23, 1980, in which the defendant's counsel stated clearly that the agreement by which the government would not pursue the criminal prosecution during the pendency of settlement negotiations was terminated, put the government on notice that thereafter defendant intended to assert whatever right it had quo ad prosecutive delays. There is no other reason for the statement in the letter. It is significant that this letter was sent early in the four year period of unexcused government inaction. We conclude that defendant's speedy trial right was timely urged. See generally United States v. Greer, supra; United States v. Herman, supra.

Once settlement negotiations between the government and Litton ceased in January of 1980, there was no further contact between the parties until 32 months later, when the government filed a motion to set a trial date. The government conceded in its memorandum that during a lengthy period it seriously considered abandoning the prosecution.

Certainly, it was reasonable for Litton to have concluded that the indictment was not being pursued. Under the circumstances, Litton should not be charged with the responsibility of taking any further action to bring the criminal charge against it to trial.

The government argues that Litton's agreement on January 25, 1979, that the case need not be set for trial within the Speedy Trial Act 60-day period, somehow waived Litton's right to assert a Sixth Amendment violation. Assuming that this agreement did in fact act as a continuing waiver of the defendant's Speedy Trial Act rights, which is very doubtful[10], it certainly did not affect Litton's constitutional interests. See 18 U.S.C. § 3173.[11] As the Supreme Court has often stated, the waiver of a constitutional right is not to be inferred:

> The Court has defined waiver as "an intentional relinquishment or abandonment of a known right or privilege." Johnson v. Zerbst, 304 U.S. 458, 464, 58 S.Ct. 1019, 1023, 82 L.Ed. 1461 (1938). Courts should "indulge every reasonable presumption against waiver," Aetna Ins. Co. v. Kennedy, 301 U.S. 389, 393, 57 S.Ct. 809, 812, 81 L.Ed. 1177 (1937), and they should "not presume acquiescence in the loss of fundamental rights," Ohio Bell Tel. Co. v. Public Utilities Comm'n, 301 U.S. 292, 307, 57 S.Ct. 724, 731, 81 L.Ed. 1093 (1937).

Barker v. Wingo, supra, at 525-6.

Litton did not waive the protection of the Sixth Amendment, but instead asserted its right to a speedy trial, at least as of January, 1980.

(D) Prejudice Caused By The Delay

In United States v. Avalos, supra, at 1116, the Fifth Circuit enumerated three principles applicable to the speedy trial factor of "prejudice":

> First, a showing of actual prejudice to the conduct of the defense will weigh heavily against the government and may lead to dismissing the indictment even when the three remaining factors are not weighted heavily in favor of the accused. When a showing of actual prejudice is conjoined with a lengthy delay by the government that is unexplained or deliberate, then a defendant states a compelling case for denial of speedy trial. *See Arrant v. Wainwright, supra,* 468 F.2d at 683.
>
> Second, where the government's lengthy delay is unexcused or purposeful, in the sense of a deliberate delay to gain tactical advantage, the government's delay is prima facie prejudicial. The government will have the burden of demonstrating that the defendant has not been prejudiced by the delay. *See Murray v. Wainwright, supra,* 450 F.2d at 471.
>
> Third, when the three other elements of *Barker's* weighing and balancing test are heavily weighted in favor of the accused, the accused need demonstrate no prejudice at all. "Prejudice—either actual or presumed—becomes totally irrelevant." *Hoskins v. Wainwright, supra,* 485 F.2d at 1192. *See Prince v. State of Alabama, supra,* 507 F.2d at 706-07.

There can be no doubt that the first two elements of *Barker*'s "weighing and balancing test", duration and reason for the delay, are very "heavily weighted" in favor of the accused. While there is no evidence that the delay was "purposeful, in the sense of a deliberate delay to gain tactical advantage" the delay was unexcused, and this suffices under *Avalos* to place upon the government the burden of "demonstrating the lack of prejudice to defendant." *Id*.. The government has not met this burden.

Alternatively, we conclude that the third principle of *Avalos* is applicable and that therefore prejudice is "totally irrelevant." While the third *Barker v. Wingo* factor, "assertion of the right" is a closer call than the first two (duration and reason for delay), it also is "weighted" in favor of the accused. We hold that the total "weight" of the three factors is indeed sufficiently "heavy" in favor of the accused to make applicable the third principle of *Avalos* and render prejudice irrelevant.

Finally, for the sake of completeness, we hold that Litton has demonstrated "actual prejudice to the conduct of the defense." *Id*.

The three types of prejudice that a speedy trial seeks to prevent were outlined by the Supreme Court in *Barker v. Wingo*, *supra*, at 532:

> This Court has identified three such interests: (i) to prevent oppressive pretrial incarceration; (ii) to minimize anxiety and concern of the accused; and (iii) to limit the possibility that the defense will be impaired. Of these, the most serious is the last, because the inability of a defendant adequately to prepare his case skews the fairness of the entire system.

Only a corporate defendant is indicted; hence the first of these interests is not a concern here. The second, relating to "anxiety", is a consideration only in that several Litton personnel have been implicated through the government's answer to a request for a bill of particulars. Although the Barker test was not designed to protect non-defendants, the Court stressed in Barker that its list of four factors was not exclusive, and, therefore, the interests of collaterally implicated individuals in a speedy trial should not be totally overlooked.

Litton emphasizes prejudice on the basis of the "most serious" of the speedy trial interests of a defendant, impairment of its defense. In particular, Litton argues that several key witnesses have died during the unexcused delay, and documents vital to the defense have been lost by the government. Before examining these complaints, we note the seeming truism that the risk of prejudice is great in a complex case based on old facts. The government agrees that the present case involves an intricate set of circumstances based upon facts which occurred over fifteen years ago. Even if much of the delay in this case is viewed as justified, the fact that long periods of justified delay have occurred simply increases the possibility of serious prejudice arising during periods of unjustified delay.

The defendant makes a strong argument with regard to the importance of one of the deceased witnesses, David Adams, who died during the period of deliberate governmental delay, in May of 1980. The government alleges that certain manpower charts were submitted to support Litton's false claim. These charts were prepared by Mr. Adams. The government does not deny the importance of Mr. Adams, but asserts that he was a government witness and his testimony is preserved by grand jury transcripts. Not surprisingly, defendant is not comforted by that explanation. The fact that such testimony, elicited without cross-examination, without representation by counsel, and without regard for the rules of evidence, may be admitted at trial compounds the problem of potential prejudice. It is the defendant, not the government, which is prejudiced by the unavailability of the witness. Moreover, defendant stresses that the now deceased witness would have testified as to a number of matters favorable to defendant, not covered in his grand jury testimony. An affidavit of one of the attorneys familiar with the situation provides specifics as to that exculpatory testimony.

Several boxes of exculpatory documents, of two different categories, have been lost while in the government's possession. The production audit documents lost were those materials accumulated by the Navy in 1970 when Litton filed its claim against the government. The missing source selection documents are the government's own documents which were the product of the Navy's 1968, pre-contract investigation of the Ingalls Shipyard's capabilities. The conclusion that compelling Litton to stand trial without these lost documents would be substantially prejudicial is not as clear as with respect to the deceased witness, Adams. However, considering all the circumstances, prejudice can reasonably be inferred.

While denying the existence of prejudice, the government argues that even if prejudice is apparent, the indictment should not be dismissed pre-trial, because the extent of the prejudice cannot be determined until the court has heard the complete factual development. Although in many cases it may be difficult to judge adequately the validity of a speedy trial complaint of prejudice prior to trial, "an accused who does successfully establish a speedy trial claim before trial will not be tried." United States v. MacDonald, 435 U.S. 850, 861 n. 8 (1978). See also United States v. Roberts, supra; United States v. Salzmann, 417 F. Supp. 1139 (E.D.N.Y.), aff'd, 548 F.2d 395 (2d Cir. 1976). Even if pre-trial dismissal is unusual, it is particularly appropriate in this most unusual case. The expected length of this trial is three to six months. Proceeding with trial under the circumstances of this prosecution is impractical, considering the immense expense, both public and private, that trial would entail. Delaying a decision as to a speedy trial violation until after trial is also undesirable from the standpoint of judicial economy.

II. SPEEDY TRIAL UNDER RULE 48(b) OF THE FEDERAL RULES OF CRIMINAL PROCEDURE

The secondary ground for dismissal raised by defendant is based on Rule 48(b) of the Federal Rules of Criminal Procedure, which provides as follows:

> If there is unnecessary delay in presenting the charge to a grand jury or in filing an information against a defendant who has been held to answer to the district court, or if there is unnecessary delay in bringing a defendant to trial, the court may dismiss the indictment, information or complaint.

The extent of a district judge's discretion under this rule is unresolved in the Fifth Circuit, but there is no question that dismissal pursuant to Rule 48(b) is required in the event of a constitutional deprivation of the Sixth Amendment right to speedy trial. United States v. Hill, 622 F.2d 900 (5th Cir. 1980); United States v. Noll, 600 F.2d 1123 (5th Cir. 1979); United States v. Gorthy, 550 F.2d 1051 (5th Cir.), cert. denied, 434 U.S. 834 (1977). Some circuits have interpreted Rule 48(b) as giving a district court the authority to dismiss in situations not involving a constitutional violation; the rule is a restatement of a court's inherent power to dismiss for want of prosecution. See, e.g., United States v. Dreyer, 533 F.2d 112 (3d Cir. 1976); United States v. Correia, 531 F.2d 1095 (1st Cir. 1976); Notes of the Advisory Committee on Fed. R. Crim. P. 48(b). In deciding whether dismissal is justified under this rule, a court should consider the same factors relevant to a constitutional decision, as outlined in Barker v. Wingo, supra, but impose a stricter standard. 3A C. Wright, Federal Practice and Procedure, § 814 (1982). Dismissal may be with or without prejudice. Id.

The government disputes that dismissal would be proper here, arguing that the rule should be exercised only after the government has been forewarned of the sanction. The government argues that this view of the rule has been adopted in the Seventh and the Ninth Circuits: United States v. Clay, 481 F.2d 133 (7th Cir. 1973); and *United States v. Simmons*, 536 F.2d 827 (9th Cir. 1976). In actuality, the *Clay* decision, relied on in *Simmons*, held that "[a]bsent such forewarning, or some other showing justifying an exercise of discretion . . . it was error to dismiss the indictment simply because unnecessary delay of approximately eight months occurred . . ." 481 F.2d at 138. *Clay* would not require forewarning here, because "there is some other showing justifying an exercise of discretion" - the excessive period of unjustifiable delay. In any event, even if *Clay*, involving an eight month delay, and *Simmons*, four months, did support the government's position, those cases would hardly be persuasive in this situation where the delay approaches four years.

Obviously, because this court has already found a constitutional deprivation of the speedy trial guarantee, a 48(b) dismissal is mandated. In the event the delay in the present case had been found to have been less than constitutional in dimension, this court would have exercised its discretion and granted Litton's motion with prejudice to the government. The length of delay and the reasons therefor are, at the least, intolerable, if not unconsitutitional.

III. CONCLUSION

We would ordinarily avoid the Sixth Amendment issue and base the decision only on the non-constitutional ground, Rule 48(b). However, because the considerations in applying either Rule 48(b) or the Sixth Amendment right to speedy trial are so similar, and because the parameters of the Rule are not clearly defined, we dismiss the indictment on both grounds.

February 28, 1983

ADRIAN G. DUPLANTIER
DISTRICT JUDGE of the EASTERN DISTRICT
OF LOUISIANA, sitting by designation

FOOTNOTES

1

18 U.S.C. § 287 provides:

> If there is unnecessary delay in presenting the charge to a grand jury or in filing an information against a defendant who has been held to answer to the district court, or if there is unnecessary delay in bringing a defendant to trial, the court may dismiss the indictment, information or complaint.

2

Defendant does not suggest that the indictment should be dismissed on the basis of the Speedy Trial Act, 18 U.S.C. §3161, et seq. The sanction of dismissal is applicable only to indictments filed on or after July 1, 1980. 18 U.S.C. § 3163(c); United States v. Horton, 646 F.2d 181 (5th Cir. 1981).

3

The Speedy Trial Act has since been amended so that the 60 day period referred to is now 70 days. 18 U.S.C. § 3161(c)(1) and (e).

4

On March 29, 1979, the government sent a letter to the trial judge stating that it had filed its objections to Litton's motions, and it "look[ed] forward to receiving further directions from the court as to a hearing date." It is well recognized that the primary responsibility for moving a criminal case to trial lies with the prosectuion. Barker v. Wingo, supra, at 527. Even in those cases in which delay is related to actions taken by the court, and this is not such a case, the government still has a responsibility to minimize the delay. United States v. Vispi, 545 F.2d 328 (2d Cir. 1976); United States v. New Buffalo Amusement Corp., 600 F.2d 368 (2d Cir. 1979); United States v. Jones, 524 F.2d 834 (D.C. Cir. 1975). All that the government needed to do in this case was to file a motion to set a hearing. Instead, the government took no action for well over three years.

5

Counsel estimated that the duration of trial would be between three and six months.

6

The government's decision to reassemble its trial team was not made until May 24, 1982, and not announced until September 22, 1982, when the motion to set for trial was filed. There is strong evidence that the May 24th decision was made only after pressure upon the Justice Department from prominent political figures. A letter dated January 13, 1982, was sent to Attorney General William French Smith by Admiral Hyman Rickover, complaining that the prosecution of Litton had "lain dormant" and that "the Justice Department is systematically closing down these investigations." Admiral Rickover notes the obvious: "[w]ith the passage of time, the likelihood of prosecution becomes more remote . . ." Another letter, this one by Senator William Proxmire dated February 24, 1982, requests that Attorney General Smith provide [Proxmire] with a status report of [the Litton case] and together with an explanation of why [it has] dragged on for so long and why [it is] being dropped." The fact that it appeared to Senator Proxmire and Admiral Rickover that the Litton prosecution was quite likely abandoned demonstrates that Litton's similar belief was justified.

FOOTNOTES CONTINUED

7

Frank W. Dunham, Jr., Special United States Attorney, Eastern District of Virginia, in responding to a suggestion by the court, stated:

> MR. DUNHAM: Your Honor, that impression that you just stated . . ., I believe more succinctly states the proposition than I could put it. Both sides were perfectly satisfied with the fact that nothing was moving forward.

8

During this period of negotiations, defendant's attorney sent a lengthy letter to a government attorney concerning specifics of settlement possibilities. The letter includes a comment that "[s]taleness is to Litton's benefit." If by referring to this letter, the government implies that its delay was justified, because it appeared that Litton was in no hurry to complete the litigation, the argument is rejected. Taken in the context of the entire letter, Litton was simply trying to persuade the government that settlement would be to the government's advantage. In any event, the letter sent by Litton's attorney less than three weeks later terminating any understanding that the parties would take no further action certainly sufficed to reinstate, if necessary, Litton's speedy trial rights.

9

Although the government's delay was not deliberate in the sense that it was motivated by a desire to hamper Litton's defense, delaying the decision to revive the prosecution until May of 1982, and failing to advise Litton for an additional four months thereafter, had the same effect.

10

See United States v. DeLongchamps, 679 F.2d 217 (11th Cir. 1982), a recent case indulging every reasonable presumption against waiver of a Speedy Trial Act right, and holding that if a waiver is found, the extent of the waiver should be interpreted narrowly.

11

18 U.S.C. § 3173 provides:

> No provision of this chapter [18 USCS §§ 3161 et seq.] shall be interpreted as a bar to any claim of denial of speedy trial as required by amendment VI of the Constitution.

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CHIEF COUNSEL TO THE MINORITY

April 26, 1983

The Honorable John Lehman
Secretary of the Navy
The Pentagon
Washington, D.C. 20301

Dear Secretary Lehman:

On April 14 I received from your office of legislative affairs, copies of four Naval Investigative Service reports regarding suspected irregularities at the Ingalls shipyard in Pascagoula, Miss. The reports had been requested by my office in early December 1982.

The response received by this Subcommitee is unsatisfactory, both in timeliness and content. Though numerous calls were made by members of my staff over the past four months requesting a prompt response, none was forthcoming.

More serious, however, is the fact that, despite our repeated requests for full, uncensored reports, each of the copies you have sent is, to one extent or another, excised. Important names and identifying data have been deleted from the reports. The N.I.S. reports furnished do not assist us in performing our legislative mandate to "study or investigate - the efficiency and economy of all branches of the Government including the possible existance of fraud, misfeasance,... mismanagement, incompetence,...waste,...and the improper expenditure of Government funds in transactions, contracts, and activities of the Government...."

I am sure you are aware that the Congress is exempt from the provisions of both the Privacy Act and Freedom of Information Act. My requests for full disclosure are not frivilous. I therefore expect to receive the complete reports, as originally requested, by April 29, 1983.

Sincerely,

Bill Roth

William V. Roth, Jr.
Chairman

WVR:JR:dgw

U.S. Department of Justice

Criminal Division

Assistant Attorney General

Washington, D.C. 20530

26 APR 1983

PERM. SUBCOMMITTEE
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APR 28 1983
ON [illegible]

Honorable William V. Roth
Chairman
Senate Permanent Subcommittee
  on Investigations
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Your letter of March 24, 1983, to the Attorney General inquiring about the Department of Justice's handling of allegations of shipbuilding fraud has been sent to the Criminal Division for reply.

As you know from your review of the recent GAO report mentioned in your letter, three shipbuilding matters have been closed. These three investigations dealt with claims submitted by Lockheed Shipbuilding in 1968, Bath Iron Works Shipbuilding in 1975, and the Electric Boat Division of General Dynamics in 1976. Allegations of false claims by two other shipbuilders, Litton Systems, Inc. and Newport News Shipbuilding, have also been the subject of investigation. Litton was the subject of an indictment that was recently dismissed by the District Court. Both the Government's appeal of the dismissal of the indictment and the investigation of the Newport News matter are pending and cannot be addressed in any detail here.

In general, the Department declined prosecution because thorough investigations revealed insufficient evidence of criminal fraud. These conclusions were reached only after extensive investigations involving a commitment of sizeable resources, and were based solely and exclusively upon the merits of the evidence developed by the Navy before referral to the Department of Justice, by lengthy grand jury proceedings and by comprehensive FBI investigations closely coordinated with lawyers in the Department of Justice.

Finally, on October 1, 1982, Attorney General William French Smith and Secretary of Defense Caspar Weinberger established a joint DOD-DOJ fraud procurement unit. This unit is operational and consists of lawyers and investigators from DOD, the military Services, and DOJ. The unit is currently working actively in developing new cases and making improvements in the conduct of fraud procurement investigations and prosecutions.

We appreciate your continuing interest in this area.

Sincerely,

Lowell Jensen

D. Lowell Jensen
Assistant Attorney General
Criminal Division

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